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401(K) FEE DISCLOSURE: HELPING WORKERS SAVE FOR RETIREMENT

HEARING

OF THE

COMMITTEE ON HEALTH, EDUCATION, LABOR, AND PENSIONS

UNITED STATES SENATE

ONE HUNDRED TENTH CONGRESS

SECOND SESSION

ON

EXAMINING 401(K) PLAN FEE DISCLOSURE, FOCUSING ON HELPING WORKERS SAVE FOR RETIREMENT

SEPTEMBER 17, 2008

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401(K) FEE DISCLOSURE: HELPING WORKERS SAVE FOR RETIREMENT

WEDNESDAY, SEPTEMBER 17, 2008

U.S. SENATE,
COMMITTEE ON HEALTH, EDUCATION, LABOR, AND PENSIONS,
Washington, DC.

The committee met, pursuant to notice, at 10:04 a.m. in Room SD–430, Dirksen Senate Office Building, Hon. Tom Harkin presiding.

Present: Senators Harkin and Enzi.

OPENING STATEMENT OF SENATOR HARKIN

Senator HARKIN. Good morning, everyone. The U.S. Senate Committee on Health, Education, Labor, and Pensions will come to order.

Though he is not here today, I would like to thank Chairman Kennedy, as well as our subcommittee chair Senator Mikulski and our Ranking Member Senator Enzi, for giving me this opportunity to hold a hearing on my legislation, S. 2473, the Defined Contribution Fee Disclosure Act.

To paraphrase Mark Twain, the reports of this bill's death have been greatly exaggerated. It is a fairly simple piece of legislation, even though there is 25 pages to it. That is simple around this place. All this legislation says is that people need enough information to make an informed decision on one of the most critical financial decisions they will ever make in their entire lifetimes.

Given this week's tumult in the stock market, this legislation is designed to address what might seem to be at first glance a small issue, but, in fact, it has a dramatic impact on the retirement security of millions of Americans who have 401(k) plans. Not many people realize this, but ERISA does not require plan sponsors to provide participants with information on the level of fees that participants are charged by the various plans that they have to choose between.

While everyone is seeing a big dip in their nest egg for the short term during each tumble that the stock market takes, those losses are temporary, I hope, and recoverable. Erosion from high fees, however, is quiet. It is long-term, insidious, and you don't recoup it. It cuts benefits by a huge amount over a long period of time.

The number of people participating in defined contribution plans grows every year, and unfortunately, these plans are a bigger part of their nest egg as more and more employers freeze or terminate defined benefit plans. One of the key things in moving from defined

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benefits to defined contributions is making sure that people have all of the information they need to help them decide which plan serves them the best.

Recently, AARP conducted a survey in which it asked individuals with 401(k) plans if they even knew what they paid each year in fees. Only 17 percent of the people asked said that they knew what their fee levels were. Well, again, it is not just an academic problem. It could be disastrous for a lot of people when they reach retirement.

One person shared with me a story that highlights what is at stake. She noticed one day that her 401(k) wasn't actually earning anything at all. After some examination, she found that the agent who set up the plan for the company received a fee of 2 percent annually for the first 5 years, reduced to 2.25 percent after that, which was paid by the employees and not the company. The investment firm charged a fee of 1.25 percent, which they said was standard for companies under $1 million.

Last year, she was paying 3.25 percent in fees and earning less than 4 percent from her money market fund. She didn't have a clue about the fees until she inquired after she realized she wasn't making any money on her fund.

So, again, if you look back at the AARP survey, of the 17 percent who said they knew what their fees were—of the 17 percent who said they knew what their fees were, 33 percent said they weren't being charged anything at all. Of course, they were charged something, but one out of three thought they weren't even being charged anything.

Some companies tell people they aren't being charged fees. Well, some companies may pay the fees, but that is not really much of the norm when they pick it up. A few may do that.

The Government Accountability Office recently estimated that a 45-year-old with $20,000 in 401(k) would have $70,550 at age 65 for his retirement, assuming he was getting a 6.5 percent return and only paying 0.5 percent in fees. But that figure decreases dramatically if the fees are increased by just a single percentage point to 1.5 percent. At that figure, the same individual investing the same amount of money would have only $58,400 for his retirement, or $12,000 less.

Consider this case. If a 35-year-old invested $20,000 in a plan over 30 years, paying 0.5 percent in fees, that individual would have $132,287 for retirement. But if you increased the fees just by 1 percent up to 1.5 percent, the amount available for retirement is only $99,679. That is a 25 percent reduction in the account balance at retirement.

A lot of times people say, "Well, I pay a fee of 0.5 percent or 1 percent or 1.25 percent, it doesn't seem like much. It just doesn't seem to amount to a lot." But when you add it up over a 25-, 30-year period of time, you can see that it can be, as I pointed out here, a reduction of 25 percent in their total amount.

Again, what has happened is over this period of time, I have gotten more and more information from people who have awakened to the fact that they have been paying into their 401(k)s for a long time, and they have been paying high fees. Then they found someone else who has not been paying very high fees at all. These things are getting matched up, and they are saying why am I not having the same kind of retirement nest egg as someone else simply because I am paying higher fees?

So the information gap, that to let both the participants and the sponsors, both, have as much knowledge as is needed so they can make informed decisions is what my bill is all about. To provide with easily understandable information about the fees they are paying. Provide it before they pick which plans they want to invest in and, again, regularly on their quarterly statements.

It would also require companies to disclose more information to the plan sponsors. Right now, if you provide a 401(k), you have a fiduciary responsibility. Well, in carrying out that fiduciary responsibility, you better have a good knowledge of what is involved and what those fees are. Sometimes there are hidden fees that aren't even disclosed to the plan sponsors.

Sometimes those sponsors also aren't told about business arrangements between service providers to steer participants into investment options in which they have a stake. Again, I think that is a classic case of a conflict of interest. So, again, the bill would require all the plan providers to disclose all fees and relationships between service providers to the people selecting the plan that the company will ultimately offer.

Again, the bottom line is that people need to be investing more and more confidently in the 401(k)s that they are being offered, especially in a world where defined benefit plans are being slashed. And for many people their only source of real retirement income, aside from Social Security, is 401(k)s.

So, again, I see the bill as a win for companies who want to provide their workers with secure retirements. It is a win, I think, for the 401(k) providers. Again, many of them have been providing really reasonable fees all along, none of this hidden stuff. But then there is always someone out there trying to game the system, trying to get a little leg up, trying to get a little bit ahead, and doing it.

So, again, I think it is a win for those responsible providers that have been providing good 401(k) plans with reasonable fees, and I think it is a win for all of the Americans who now are investing in their 401(k) plans.

And before I introduce our witnesses, I would recognize our distinguished Ranking Member, Senator Enzi.

OPENING STATEMENT OF SENATOR ENZI

Senator ENZI. Well, thank you, Mr. Chairman. I want to congratulate you on the work that you have done on this issue and for holding this hearing. It is a very important hearing and a very timely hearing.

Our crowd isn't as big as it is sometimes for hearings. I think that is because we are going to be talking about numbers.

[Laughter.]

As the only accountant in the Senate, though, this is one of my favorite kind of hearings.

Senator HARKIN. You know about this stuff.

Senator ENZI. Yes, I actually filled out several of the Form 5500s that we will talk about, and I have looked at the chart there and find it fascinating that the fund that is giving the biggest return also has the lowest operating expense.

Senator HARKIN. Say that again, Mike.

Senator ENZI. The fund that is giving the biggest return on that chart has the lowest operating expense.

Senator HARKIN. Interesting.

Senator ENZI. That is kind of an anomaly, but I am trying to figure out how you get people to actually take a look at the numbers, even if we provide the numbers. How do you get them to look at the numbers? How do you get them to understand the numbers?

I think part of that is due to our education system. I don't think we run them by enough charts like this that they can understand what they are or even the importance of investing in 401(k)s. So we are holding this hearing at a very opportune time. What is occurring in our capital markets holds key lessons for individuals who are investing their retirement savings for their golden years. We should diversify our investments, and we should not take on too much risk. Those are the two principal foundations of investing.

Unfortunately, our financial institutions seem to have forgotten those rules. We can't afford to do the same with retirement savings. The Department of Labor tells us that there are nearly $2.3 trillion in 401(k)s and related accounts invested in capital markets, and we have to invest these moneys prudently.

Now, with respect to the fees paid on these accounts, over the years we have been told by experts that fees matter, and the smallest increase in fees can cost thousands of dollars over a 20- to 30-year period. However, we have also been told that we cannot just pay attention to fees. We also need to make the right financial investments based on our families' needs for the future.

Last week, a major news publication printed an article in which the reporter sought to find out how much she was paying in 401(k) fees and whether those fees were in line with the fees paid by others for similar investments. I request unanimous consent to have the article included in the record.

Senator HARKIN. Without objection.

[The information referred to follows:]

[Wall Street Journal—September 10, 2008]

(By Karen Blumenthal)

HOW MUCH DOES YOUR 401(K) COST YOU?

PAGE D1—You may not realize it, but you could be paying thousands of dollars a year in fees on your 401(k) retirement account, hidden expenses that affect how your savings will grow. The government is now trying to expose those charges so you can make better investment decisions.

Under regulations proposed by the Department of Labor, 401(k) plans every year will have to disclose each investment's annual expense ratio—the percentage that goes to management and other costs—along with more detailed performance data. In addition, any administrative or other fees deducted from your account will have to be spelled out. New regulations may go into effect as soon as Jan. 1.

The fees and other costs we pay are hard to find because they're taken out before we see investment results. But they are significant because they nibble into our returns now, and, over decades, they can take a huge bite out of our future savings tally. Perhaps more important, expense ratios—even more than an investment's past performance—turn out to be a strong indicator of how a mutual fund will fare down the road.

"In almost every study we've run, expenses show up as a very significant predictor of future performance," says Christine Benz, director of personal finance at Morningstar Inc., the investment research firm. In other words, over time, funds with lower fees are likely to outperform those with higher fees in the same category. By contrast, says Ms. Benz, "our data indicates that past performance is a weak indicator" of future results.

But even with more information, understanding and making sense of investment expenses can be a mind-bender. To get a handle on them, I decided to dig into my own 401(k) account to see what I was paying and what I could do about it. The plan is a typical one, and the exercise turned out to be revealing—and somewhat painful.

Finding the details. Many plans, but not all, provide performance data on the various mutual funds and other investment options they offer, though they may not detail the 1-, 3- and 5-year data and equivalent benchmark performance that the Labor Department will likely require. Yet plans don't currently have to detail the administrative fees or the expenses built into investment choices, and finding those can be tedious and time-consuming.

My plan is managed by Fidelity Investments, which provides lots of information on a fairly user-friendly Web site. It was easy to find the expense-ratio link for the Spartan International Index fund, for instance. But once there, the numbers were confounding: There were three separate expense ratios—0.2 percent as of April, 0.1 percent after reductions as of February and 0.1 percent after a cap on expenses in 2005. It took conversations with three people at Fidelity to confirm that the expenses are capped at $10 for every $10,000 invested. Finding the fund's prospectus—which contained details on the expenses—required a few extra clicks.

My funds don't come with any "loads," the sales charges assessed when you buy or sell a fund. Neither do they assess so-called 12b-1 sales and marketing fees. But your funds might. Some of mine do assess penalties for short-term trading, but I'm way too lazy to move into and out of funds frequently.

To find out who pays my 401(k) plan's administrative expenses—those outside of individual funds—I needed to locate something called the Summary Plan Description. That required a call to my employer's benefits department to get a copy. I learned on page 87 that the company picks up the modest legal and accounting fees, and the rest of the expenses appear to be paid from what Fidelity already charges. That's good news: Some plans actually charge participants for all or part of the administrative cost.

How cheap is it? Knowing that the Fidelity Growth fund charges $94 in expenses for every $10,000 invested still didn't tell me if those expenses were reasonable. Fred Reish, a Los Angeles lawyer specializing in employee benefits, cautions against looking at the average expense ratios for, say, large growth funds, since those averages include high-cost retail funds that wouldn't normally be in a 401(k). Instead, he suggests a better comparison would be the funds with the lowest expenses in their category.

At the Morningstar.com1 site, I put in the fund's ticker symbol (FDGRX) and clicked on a little "i" next to the expenses number. That showed me the fund's expenses were well below the category average of $137 per $10,000 invested, but still fell into the second quartile. In other words, this fund was more department store than Target, cost-wise.

Michael Callahan, of pension consultant Pentec Inc., says he would consider expensive any U.S. stock fund with an expense ratio over 1.5 percent, or an international fund with a ratio of 2 percent or more.

Using another free Morningstar tool called Xray, I entered all my stock funds and found that my average expense ratio was 0.36 percent, or $36 per $10,000 invested, mostly because I lean toward index funds and Fidelity's are among the cheapest.

I was feeling pretty smug—but there was a catch. I couldn't find the expense ratio for one of my favorite investments, a company-sponsored "guaranteed investment contract" fund, which functions as sort of a low-volatility intermediate bond fund. The new Labor Department rules will require disclosure of expense ratios for these types of funds, as well as for collective trusts, which operate like mutual funds but aren't subject to regulation.

Gina Mitchell, president of the Stable Value Investment Association, a trade group, says the typical guaranteed-investment-contract fund has an expense ratio that ranges from about 0.4 percent to about 0.8 percent, depending on whether administrative fees are included. The higher end of the range is more than the bond-fund offerings in my plan charge. If it applies to my account, it would raise my average overall cost to about half a percentage point, or around $2,500 a year in expenses on a $500,000 portfolio.

Figuring out your overall cost is especially important if you are deciding whether to keep your 401(k) with a former employer. Hewitt Associates compared the expenses of a typical 401(k) and the retail costs of an individual retirement account, and found that a 35-year-old saver who chose the IRA could end up with 9 percent to 18 percent less in her retirement account at age 70 than if she stayed in the original plan. If your plan charges high expenses, you may also want to consider how much of your income you want to invest in it, beyond capturing the full employer match.

What to do now. Even with differences in costs among funds, don't invest based on expenses alone. They should only be a factor, along with your asset mix, the fund's ranking among its peers and its long-term performance.

Consider my international stock funds: Spartan International Index and Fidelity Diversified International, a managed fund with 10 times the expenses—$102 per $10,000. Even with much-higher costs, the managed fund has outperformed the index fund over 3, 5 and 10 years.

Over the long run, the cheaper index fund may ultimately do better. But in the meantime, I appreciate the managed fund's outstanding performance. My solution: Divide my international piece between the two. I will also now watch the managed fund more diligently. The higher costs underscore why we need to expect more from actively managed funds and avoid them if they don't routinely offer superior results or diversification.

You can find out more about the proposed disclosure changes at the Labor Department's Employee Benefits Security Administration site (www.dol.gov/ebsa[2]). Comments are due this week; you can e-mail yours to e-ORI@dol.gov[3], with the subject line "Participant fee disclosure project."

Email: familymoney@wsj.com[4]

Senator ENZI. The good news is that she was able to find the information. The bad news is that it was an exhausting journey because she had to seek out computer programs and expert advice that were not given to her employer.

She found that her index fund fees were smaller than the industry norm. However, her international fund fees were a bit higher. After careful analysis, she decided to keep her international fund investment because it would deliver higher returns over the long-term.

We can make 401(k) fees as transparent as we like, but if we don't provide the tools for employees and individuals on how to interpret and compare the information, then the information is useless. Last week, Apple Computer's Steve Jobs had a major press conference on his new innovations. One of his new ideas was something called Genius software.

This Genius software would enable a person to pick one song from his or her library of music, and then the software would put together a song list. If we are able to have Genius software for music, why can't we have Genius software for retirement savings? If we gave the iPod generation Genius software for their retirement savings, then we can be sure that our youngest generation is set for their golden years as they are set for their music today.

People, of course, are a little worried about how much people might learn about them. But a lot of them have the little grocery store discount things. That helps them to make sure that the right things are on the shelf at the right time and they know what people are going to buy.

We watch the ads for eHarmony. That is picking a future mate by a computer software program. I am not sure why we don't have the same thing for stocks. You know, put in goals, wind up with a list. It might have something to do with the liability question, though.

But recently, Chairman Chris Cox of the Securities and Exchange Commission embarked on an initiative to require companies to use Extensive Business Reporting Language, XBRL, for companies and mutual funds to tag the data in their financial disclosures. The concept is based on a very similar concept used by Steve Jobs. But instead of tagging song titles, the SEC wants to tag financial earnings, fees, and asset holdings.

With this type of innovation for retirement savings, I envision that computer models could easily produce useful, meaningful, transparent disclosures based upon each employee's and their family's needs.

Mr. Chairman, I do want to thank you for working with us to invite two small business persons to testify. Under the Pension Protection Act, we made great strides in reducing the hurdles for companies to establish auto-enrollment 401(k) plans. However, we still lag behind in the number of small businesses offering retirement benefit plans.

According to recent data by the Congressional Research Service, only 26 percent of employers with fewer than 25 employees have retirement plans. This compares to 65 percent of all large companies that have pension plans.

Anything that we do with respect to 401(k) fee disclosure and investor education should not place disproportionate burdens on small entities, nor should it saddle them with additional liability. And we already do provide some exclusions for small businesses, but we don't have the education programs to get them involved in providing it for their employees.

I believe that everyone in the room today shares the same goal of providing better 401 fee disclosure. However, we should now be looking down the road and harness technology to make that information more useful and meaningful to working families. They are the only ones who can make the necessary choices to address their own needs.

I thank you for holding this important hearing today.

Senator HARKIN. Thank you very much, Senator Enzi. Thanks for all your help in developing this and moving this hearing along. Hopefully, we will get something done here.

We have two panels, and we have a short morning here. We have to be out of there by shortly after 11 o'clock. Our first panel would be Assistant Secretary Bradford Campbell, Department of Labor, in charge of the Employee Benefits Security Administration, Washington, DC.

Mr. Secretary, we have your statement in its entirety. Again, I would ask you if you could just summarize it in 5 to 7 minutes, then we could have an interchange before we bring up our second panel.

So welcome to the committee, Mr. Campbell, and please proceed.

STATEMENT OF BRADFORD P. CAMPBELL, ASSISTANT SECRETARY, DEPARTMENT OF LABOR, EMPLOYEE BENEFITS SECURITY ADMINISTRATION, WASHINGTON, DC

Mr. CAMPBELL. Well, thank you, Mr. Chairman, Senator Enzi and other members of the committee.

I want to thank you for the opportunity to come here today to testify about the Department of Labor's significant progress in promulgating regulations that we have developed to address these very issues of fee and expense and conflict of interest information in 401(k) and other employee benefit plans. These regulations are a top priority for the Department of Labor.

As you noted, over the past 20 years, the retirement universe has changed, and there are significant changes affecting both workers and plan fiduciaries who are making decisions about their plans. More workers now control the investment of the retirement assets in participant-directed individual account plans, such as 401(k) plans, and they need better tools to make informed decisions.

Plan fiduciaries, who are charged by law with paying only reasonable fees for necessary services, have found their jobs more difficult as both the number and types of fees proliferate and the relationships between financial service providers have become more complex.

These trends caused the Department to conclude that despite the success we have been having in our enforcement efforts and our education and outreach efforts to participants and fiduciaries, a new regulatory framework was necessary to better protect the interests of America's workers, retirees, and their families. That is why we began several years ago initiating a series of three major regulations, each addressing a different aspect of this problem.

The first regulation addresses the needs of participants for concise, useful, comparative information about their plan's investment options. The second regulation addresses the needs of plan fiduciaries, who require more comprehensive disclosures by service providers to enable them to carry out their duties under the law. And the third regulation addresses disclosures made by the plan to the public and the Government in the annual Form 5500, which is filed with the Labor Department by these plans.

It is essential to understand, I believe, that the disclosure needs of each of these groups is different, and that is exactly why we structured this in three separate regulations, which are each targeted to those different needs.

Participants are choosing their investments from among a defined universe of options that are in their plan. And to do this, they need concise summary information that allows them to compare those options in meaningful ways that take into account the fees that they are paying, the historical rates of return, the nature of the investment, and the other relevant factors that one considers in making a long-term retirement investment decision.

Our proposed regulation will, for the very first time, ensure that all 65 million Americans in these plans have the basic information that they need to make these decisions and that they can actually use to compare across investment products. So instead of throwing up their hands and throwing out 12 of 14 or however many prospectuses might be passed through the participant that are unread, by and large, workers will be able to use the model disclosure form, which we have a sample of here for you to review, that would help them find this basic information they need in a very useful format.

Now there is widespread agreement in the comments that we have received throughout this process—from workers, from consumer groups, from plan sponsors, employers—that a 50-page written document in legalese isn't helpful to workers. It just costs more money to prepare. And that is exactly what our proposals are intended to avoid to provide workers with useful information.

Plan fiduciaries have a different duty than workers in making these choices, and it requires a different and more comprehensive disclosure. Fiduciaries are trying to decide if the services the plan is receiving are necessary and if the prices that are being charged for those services are reasonable, that is taking into account the needs of the plan as a whole.

These fiduciaries need to know whether the services that are being provided are going to be influenced by compensation arrangements between the service providers and third parties, whether the direct charges that the plan is paying to the service provider are properly reflecting any payments that the service provider is receiving from a third party such as revenue sharing or other arrangements, what services they will be receiving and information of that nature that they need to assess all of the factors involved.

Our final regulation in this area will ensure that fiduciaries get this information before they are entering into these arrangements so that they can carry out their obligations to the workers.

I do want to note that we are nearing the end of what has been a multiyear process. It is a comprehensive public regulatory process. The final regulation that provided the disclosures to the Government and the public in the Form 5500 was promulgated last year.

Last year, we also proposed the regulation requiring disclosures from service providers to plans, and we held 2 days of administrative hearings to further augment the record on these issues that were raised this spring. We will be issuing a final regulation in the next several months.

This summer, we proposed the participant disclosure regulation, and the comment period on that recently closed. We are in the process of evaluating those comments, and we will promulgate a final regulation this year.

I do want to commend the committee for its interest in enhanced fee and expense disclosure. I think it is a very important area that we should all be looking at.

But, I do want to note that the Department has the authority under current law to undertake these regulatory initiatives, and we have been exercising it to ensure that workers are protected from exactly the concerns that have been raised in the congressional hearings that have been held on this topic. And I think that our very deliberative and open process of rulemaking has been very conducive to addressing some of the fairly complex technical issues that have been presented.

In conclusion, Mr. Chairman and Senator Enzi and the committee, I want to thank you for the opportunity to come here and for your interest in this important issue because it is crucial to ensuring that Americans have adequate retirement savings and adequate retirement income.

I am committed to ensuring that our regulatory projects are completed in a timely manner, and I appreciate the opportunity to address those and would be happy to answer any questions you have.

[The prepared statement of Mr. Campbell follows:]

Prepared Statement of Bradford P. Campbell

INTRODUCTORY REMARKS

Good morning Chairman Harkin, Ranking Member Enzi, and members of the committee. Thank you for inviting me to discuss plan fees, the Department of Labor's role in overseeing plan fees, and proposals to increase transparency and disclosure of plan fee and expense information. I am Bradford Campbell, the Assistant Secretary of Labor for the Employee Benefits Security Administration (EBSA). I am proud to be here today representing the Department of Labor and EBSA. Our mission is to protect the security of retirement, health and other employee benefits for America's workers, retirees and their families, and to support the growth of our private benefits system.

Ensuring the security of retirement benefits is a core mission of EBSA, and one of this Administration's highest priorities. Excessive fees can undermine retirement security by reducing the accumulation of assets. It is therefore critical that plan participants, directing the investment of their contributions, and plan fiduciaries, charged with the responsibility of prudently selecting service providers and paying only reasonable fees and expenses, have the information they need to make appropriate decisions.

That is why the Department began a series of regulatory initiatives to expand disclosure requirements in three distinct areas:

1. Disclosures by plans to participants to assist in making investment decisions;
2. Disclosures by service providers to plan fiduciaries to assist in assessing the reasonableness of provider compensation and potential conflicts of interest; and
3. More efficient, expanded fee and compensation disclosures to the government and the public through a substantially revised, electronically filed Form 5500 Annual Report.

Each of these projects addresses different disclosure needs, and our regulations are tailored to ensure that appropriate disclosures are made in a cost-effective manner. For example, participants are unlikely to find useful extensive disclosure documents written in "legalese"—instead, it appears from comments we received thus far that participants want concise and readily understandable comparative information about plan costs and their investment options. By contrast, plan fiduciaries want detailed disclosures in order to properly carry out their duties under the law, enabling them to understand the nature of the services being provided, all fees and expenses received for the services, any conflicts of interest on the part of the service provider, and any indirect compensation providers may receive in connection with the plan's business.

We have made significant progress on these projects. On November 16, 2007, we issued a final regulation requiring additional public disclosure of fee and expense information on the Form 5500. On December 13, 2007, we published a proposed regulation requiring specific and comprehensive disclosures to plan fiduciaries by service providers, and held 2 days of administrative hearings on the proposed regulation on March 31 and April 1, 2008, and we plan to complete a final regulation this year. On July 23, 2008, we published a proposed rule requiring plans to disclose fee and expense, investment return and other essential information to plan participants. This proposal was informed by public comments on participant disclosures we received following a Request for Information published on April 25, 2007. The public comment period on the proposed regulation recently closed, and we are evaluating the comments received from consumer groups, plan sponsors, service providers and others as we work to finalize the proposal.

The Employee Retirement Income Security Act of 1974 (ERISA) provides the Secretary of Labor with broad regulatory authority, enabling the Department to pursue these comprehensive disclosure initiatives without need for a statutory amendment. The regulatory process currently underway ensures that all voices and points of view will be heard and provides an effective means of resolving the many complex and technical issues presented. I hope that as Congress considers this issue, it recognizes the Department's existing statutory authority and takes no action that could disrupt our current efforts to provide these important disclosures to workers. My testimony today will discuss in more detail the Department's activities related to plan fees. Also, I will describe the Department's regulatory and enforcement initiatives focused on improving the transparency of fee and expense information for both plan fiduciaries and participants.

BACKGROUND

EBSA is responsible for administering and enforcing the fiduciary, reporting, and disclosure provisions of Title I of ERISA. EBSA oversees approximately 679,000 private pension plans, including 387,000 participant-directed individual account plans such as 401(k) plans, and millions of private health and welfare plans that are subject to ERISA.[1] Participant-directed individual account plans under our jurisdiction hold over $2.2 trillion in assets and cover more than 65 million participants. Since 401(k)-type plans began to proliferate in the early 1980s, the number of employees investing through these types of plans has grown dramatically. Assets held in these plans are, in real terms, more than 13 times greater than the amount held in 1984 and have increased by 22.5 percent since 2000. EBSA employs a comprehensive, integrated approach encompassing programs for enforcement, compliance assistance, interpretive guidance, legislation, and research to protect and advance the retirement security of our Nation's workers and retirees.

Title I of ERISA establishes standards of fiduciary conduct for persons who are responsible for the administration and management of benefit plans. It also establishes standards for the reporting of plan-related financial and benefit information to the Department, the IRS and the Pension Benefit Guaranty Corporation (PBGC), and the disclosure of essential plan-related information to participants and beneficiaries.

THE FIDUCIARY'S ROLE

ERISA requires plan fiduciaries to discharge their duties solely in the interest of plan participants and beneficiaries, and for the exclusive purpose of providing benefits and defraying reasonable expenses of plan administration. In discharging their duties, fiduciaries must act prudently and in accordance with the documents governing the plan. If a fiduciary's conduct fails to meet ERISA's standards, the fiduciary is personally liable for plan losses attributable to such failure.

ERISA protects participants and beneficiaries, as well as plan sponsors, by holding plan fiduciaries accountable for prudently selecting plan investments and service providers. In carrying out this responsibility, plan fiduciaries must take into account relevant information relating to the plan, the investments available under the plan, and the service provider, and are specifically obligated to consider fees and expenses.

ERISA prohibits the payment of fees to service providers unless the services are necessary and provided pursuant to a reasonable contract, and the plan pays no more than reasonable compensation. Thus, plan fiduciaries must ensure that fees paid to service providers and other expenses of the plan are reasonable in light of the level and quality of services provided. Plan fiduciaries must also be able to assess whether revenue sharing or other indirect compensation arrangements create conflicts of interest on the part of the service provider that might affect the quality of the services to be performed. These responsibilities are ongoing. After initially selecting service providers and investments for their plans, fiduciaries are required to monitor plan fees and expenses to determine whether they continue to be reasonable and whether there are conflicts of interest.

EBSA'S COMPLIANCE ASSISTANCE ACTIVITIES

EBSA assists plan fiduciaries and others in understanding their obligations under ERISA, including the importance of understanding service provider fees and relationships, by providing interpretive guidance[2] and making related materials available on its Web site. One such publication developed by EBSA is *Understanding Retirement Plan Fees and Expenses*, which provides general information about plan fees and expenses. In conjunction with the Securities and Exchange Commission, we also developed a fact sheet, "Selecting and Monitoring Pension Consultants—Tips for Plan Fiduciaries." This fact sheet contains a set of questions to assist plan fiduciaries in evaluating the objectivity of pension consultant recommendations.

EBSA also has made available on its Web site a model "401(k) Plan Fee Disclosure Form" to assist fiduciaries of individual account pension plans when analyzing and comparing the costs associated with selecting service providers and investment products. This form is the product of a coordinated effort of the American Bankers Association, Investment Company Institute, and the American Council of Life Insurers.

To help educate plan sponsors and fiduciaries about their obligations under ERISA, EBSA conducts numerous educational and outreach activities. Our campaign, "Getting It Right—Know Your Fiduciary Responsibilities," includes nationwide educational seminars to help plan sponsors understand the law. The program

[1] Based on 2005 filings of the Form 5500.

[2] *See, e.g.*, Field Assistance Bulletin 2002–3 (November 5, 2002) and Advisory Opinions 2003–9A (June 25, 2003), 97–16A (May 22, 1997), and 97–15A (May 22, 1997).

focuses on fiduciary obligations, especially related to the importance of selecting plan service providers and the role of fee and compensation considerations in that selection process. EBSA has conducted 26 fiduciary education programs since May 2004 in different cities throughout the United States. EBSA also has conducted 58 health benefits education seminars, covering nearly every State, since 2001. Beginning in February 2005, these seminars added a focus on fiduciary responsibilities. EBSA will continue to provide seminars in additional locations under each program.

DISCLOSURES TO PARTICIPANTS UNDER CURRENT LAW

ERISA currently provides for a number of disclosures aimed at providing participants and beneficiaries information about their plans' investments. For example, information is provided to participants through summary plan descriptions and summary annual reports. Under the Pension Protection Act of 2006, plan administrators are required to automatically furnish pension benefit statements to plan participants and beneficiaries. The Department issued Field Assistance Bulletins in December 2006 and in October 2007 to provide initial guidance on complying with the new statutory requirements. Statements must be furnished at least once each quarter, in the case of individual account plans that permit participants to direct their investments, and at least once each year, in the case of individual account plans that do not permit participants to direct their investments. Other disclosures, such as copies of the plan documents, are available to participants on request.

Additional disclosures may be required by the Department's rules concerning whether a participant has "exercised control" over his or her account. ERISA section 404(c) provides that plan fiduciaries are not liable for investment losses which result from the participant's exercise of control. A number of conditions must be satisfied, including that specified information concerning plan investments must be provided to plan participants. Information fundamental to participants' investment decisions must be furnished automatically. Additional information must be provided on request.

EBSA PARTICIPANT EDUCATION AND OUTREACH ACTIVITIES

EBSA is committed to assisting plan participants and beneficiaries in understanding the importance of plan fees and expenses and the effect of those fees and expenses on retirement savings. EBSA has developed educational brochures and materials available for distribution and through our Web site. EBSA's brochure entitled *A Look at 401(k) Plan Fees for Employees* is targeted to participants and beneficiaries of 401(k) plans who are responsible for directing their own investments. The brochure answers frequently asked questions about fees and highlights the most common fees, and is designed to encourage participants to make informed investment decisions and to consider fees as a factor in decisionmaking. Last fiscal year, EBSA distributed over 5,400 copies of this brochure, and over 46,000 visitors viewed the brochure on our Web site.

More general information is provided in the publications, *What You Should Know about Your Retirement Plan and Taking the Mystery out of Retirement Planning*. In the same period, EBSA distributed over 86,000 copies of these two brochures, and almost 102,000 visitors viewed these materials on our Web site. EBSA's *Study of 401(k) Plan Fees and Expenses*, which describes differences in fee structures faced by plan sponsors when they purchase services from outside providers, is also available.

REGULATORY INITIATIVES

EBSA has completed one initiative and currently is finalizing two others to improve the transparency of fee and expense information to participants, plan sponsors and fiduciaries. We began these initiatives, in part, to address concerns that participants are not receiving information in a format useful to them in making investment decisions, and that plan fiduciaries are having difficulty getting needed fee and compensation arrangement information from service providers to fully satisfy their fiduciary duties. The needs of participants and plan fiduciaries are changing as the financial services industry evolves, offering an increasingly complex array of products and services.

Disclosures to Participants

On April 25, 2007, the Department published a Request for Information, inviting suggestions from plan participants, sponsors, service providers, consumer advocates and others for improving the current disclosures applicable to participant-directed individual account plans. In response to this request, the Department received more than 100 comment letters from a variety of interested parties. Drawing on these comments, the Department developed a proposed rule that will, upon adoption, require fiduciaries of all participant-directed individual account plans—not just plans electing to comply with section 404(c)—to furnish to the plan's participants and beneficiaries important plan and investment-related information. This proposed regulation, published in the July 23, 2008 Federal Register, will ensure that all participants who are responsible for making investment decisions under their plan receive understandable information about their plan and the investments offered thereunder, including information about the fees and expenses that directly affect their retirement savings.

A major challenge in developing the proposal was determining precisely what information plans should be required to disclose to participants. Many commenting on the Request for Information encouraged the Department to keep in mind that, while appropriate disclosures are helpful, simply mandating the disclosure of page after page of legal jargon is actually contrary to the interests of participants, as the quantity of information may be overwhelming to participants and the benefits may not justify the cost, which are likely to be charged against the accounts of participants. Our proposal adopts a disclosure framework that favors quality over quantity, providing plan participants with concise, useful information in a format that facilitates comparative judgments between plans' investment options.

Specifically, the proposal would require that participants be furnished, upon enrollment and at specified intervals thereafter, two general categories of information—"plan-related information" and "investment-related information."

Plan-related information primarily encompasses administrative expenses of the plan, such as legal and accounting fees, and expenses related to the actions of a specific participant, such as a loan processing fee. In addition to requiring descriptions of what and how these fees and expenses are assessed, to be furnished upon enrollment and at least annually thereafter, the proposal requires that the amounts actually charged against a participant's account for such expenses be disclosed quarterly, noting that this quarterly disclosure requirement could be satisfied by including the required information on the participant's quarterly benefit statement.

With respect to investment-related information, the proposal provides for the disclosure of specific information regarding each designated investment option and that such information be disclosed in a form that facilitates comparisons of investments. The proposal also includes a model comparative disclosure form. The specific investment-related information required to be disclosed under the proposal includes:

- The name of each investment option, type or category of the investment (e.g., money market fund, balanced fund, etc.), and whether the investment is actively or passively managed.
- Information about the performance of each investment over 1-, 5-, and 10-year periods.
- Benchmarks against which each investment may be compared in terms of performance.
- Fee and expense information with respect to each investment—specifically, the total operating expenses, and any shareholder-type fees that might be charged directly against the participant's investment.

In addition, a Web site address is required to be provided with respect to each designated investment option for those participants who want additional information about their investment choices. The Web site would, at a minimum, make available information concerning the principal investment strategies, attendant risks, investments comprising the portfolio, portfolio turnover, etc.—similar to the information that would be contained in more detailed prospectuses.

The comment period on the proposal closed on September 8. Although we have not yet finished reviewing all of the comment letters, let me just say that we are pleased to see that so many stakeholders under ERISA support simple and short communications between plans and participants as the most helpful and meaningful.

Disclosures to Plan Fiduciaries

On December 13, 2007, EBSA issued a proposed regulation amending its current regulation under ERISA section 408(b)(2) to clarify the information fiduciaries must receive and service providers must disclose for purposes of determining whether a contract or arrangement is "reasonable," as required by ERISA's statutory exemption for service arrangements. Our intent is to ensure that service providers entering into or renewing contracts with plans disclose to plan fiduciaries comprehensive and accurate information concerning the providers' receipt of direct and indirect compensation or fees and the potential for conflicts of interest that may affect the provider's performance of services. The information provided must be sufficient for fiduciaries to make informed decisions about the services that will be provided, the costs of those services, and potential conflicts of interest based on fees or compensation. The Department believes that such disclosures are critical to ensuring that contracts and arrangements are "reasonable" within the meaning of the statute. Public comments on the proposed regulation are currently under review and we are working on developing a final regulation.

Disclosures to the Public

On November 16, 2007, EBSA promulgated a final regulation revising the Form 5500 Annual Report filed with the Department to complement the information obtained by plan fiduciaries as part of the service provider selection or renewal process. The Form 5500 is a joint report for the Department of Labor, Internal Revenue Service and PBGC that includes information about the plan's operation, funding, assets, and investments. The Department collects information on service provider fees through the Form 5500 Schedule C.

Consistent with recommendations of the ERISA Advisory Council Working Group, the Department published a final regulation amending the Form 5500, including changes that expand the service provider information required to be reported on the Schedule C. The changes more specifically define the information that must be reported concerning the "indirect" compensation service providers received from parties other than the plan or plan sponsor, including revenue sharing arrangements among service providers to plans. The changes to the Schedule C were designed to assist plan fiduciaries in monitoring the reasonableness of compensation service providers receive for services and potential conflicts of interest that might affect the quality of those services.

We intend that the changes to the Schedule C will work in tandem with our 408(b)(2) initiative. The amendment to our 408(b)(2) regulation will provide up front disclosures to plan fiduciaries, and the Schedule C revisions will reinforce the plan fiduciary's obligation to understand and monitor these fee disclosures. The Schedule C remains a requirement for plans with 100 or more participants, which is consistent with long-standing congressional direction to simplify reporting requirements for small plans.

EBSA'S ENFORCEMENT EFFORTS

EBSA has devoted enforcement resources to this area, seeking to detect, correct and deter violations such as excessive fees and expenses, and failure by fiduciaries to monitor on-going fee structure arrangements. From fiscal year 1999 through August 2008, we closed 674 401(k) investigations involving these issues, with monetary results of over $131 million.

In carrying out its enforcement responsibilities, EBSA conducts civil and criminal investigations to determine whether the provisions of ERISA or other Federal laws related to employee benefit plans have been violated. EBSA regularly works in coordination with other Federal and State enforcement agencies, including the Department's Office of the Inspector General, the Internal Revenue Service, the Department of Justice (including the Federal Bureau of Investigation), the Securities and Exchange Commission, the PBGC, the Federal banking agencies, State insurance commissioners, and State attorneys general.

EBSA is continuing to focus enforcement efforts on compensation arrangements between pension plan sponsors and service providers hired to assist in the investment of plan assets. EBSA's Consultant/Adviser Project (CAP), created in October 2006, addresses conflicts of interest and the receipt of indirect, undisclosed compensation by pension consultants and other investment advisers. Our investigations seek to determine whether the receipt of such compensation violates ERISA because the adviser or consultant used its status with respect to a benefit plan to generate additional fees for itself or its affiliates. The primary focus of CAP is on the potential civil and criminal violations arising from the receipt of indirect, undisclosed compensation. A related objective is to determine whether plan sponsors and fiduciaries understand the compensation and fee arrangements they enter into in order to prudently select, retain, and monitor pension consultants and investment advisers. CAP will also seek to identify potential criminal violations, such as kickbacks or fraud.

CONCERNS REGARDING LEGISLATIVE PROPOSALS

While I am pleased that the Department's regulatory initiatives and the legislative proposals introduced in Congress share the common goal of providing increased transparency of fee and expense information, I am concerned that legislative action could disrupt the Department's ongoing efforts to provide these important disclosures. Proposed legislation may not achieve the primary goal of participant disclosures—providing workers with useful and concise information—by mandating very detailed and costly disclosure documents. Excessively detailed disclosures are likely to be ignored by participants even as those participants bear the potentially significant cost of their preparation and distribution. Participants are most likely to benefit from concise disclosures that allow them to meaningfully compare the investment options in their plans. The Department has received many comments highlighting the importance of brevity and relevance in disclosures to participants. The regulatory process is well-suited to resolving the many technical issues arising as we seek to strike the proper balance in providing participants with cost-effective, concise, meaningful information.

I am also concerned by proposals suggesting that specific investment options should be mandated. Requiring specific investment options would limit the ability of employers and workers together to design plans that best serve their mutual needs in a changing marketplace.

CONCLUSION

Mr. Chairman and members of the committee, thank you for the opportunity to testify before you today. The Department is committed to ensuring that plans and participants pay fair, competitive and transparent prices for services that benefit them—and to combating instances where fees are excessive or hidden. We are moving as quickly as possible consistent with the requirements of the regulatory process to complete our disclosure initiatives, and we believe they will improve the retirement security of America's workers, retirees and their families. I will be pleased to answer any questions you may have.

Senator HARKIN. Thank you very much, Mr. Secretary, and I appreciate that.

Getting to this model comparative chart that you came up with, the AARP conducted a survey last month comparing participant reaction to your model disclosure form to one that they came up with and said in a letter to you, which they obviously sent to me, that, "Roughly a third or fewer respondents agree that DOL's model disclosure form is easy to read—30 percent; is easy to understand—25 percent; has a clear purpose—33 percent; has terms that are clearly defined—24 percent; and explains how to get additional information—35 percent."

"In contrast, at least 7 in 10 respondents who viewed AARP's form agree that AARP's model disclosure form is easy to read—77 percent; easy to understand—72 percent; has a clear purpose—78 percent; has terms that are clearly defined—70 percent; and explains how to get additional information—75 percent."

I am asking how would you respond to this? Is it possible that DOL would amend the model disclosure to incorporate some of AARP's suggestions?

Mr. CAMPBELL. Actually, my staff and I met with the AARP earlier this week to discuss exactly the issues that they raised in their comment, and I would say that that is the benefit of the notice and comment rulemaking process in that we get the expertise across the spectrum of workers and advocates and others to help us inform what the final regulation will look like.

I do think there are a couple of important differences in what we proposed with the AARP's form that go to the fact that their form had a slightly different purpose. It was a retrospective analysis of what an individual paid in the options they were already in, whereas our model disclosure is intended to provide a prospective view of the entirety of the options in the plan so that participants can select among them.

I think the other big difference between the two dealt with the disclosure of historical rates of return and, just as importantly, benchmarks to compare those rates to. I think that was something the survey also revealed was very valuable to participants. So, again, we certainly appreciate those comments, and we will be happy to consider them as we go through the process.

Senator HARKIN. I hope so. Again, I look at this model comparative chart, and say, I will tell you what I should invest in. I should get into that fund there, the Russell 1,000 there, maybe. Or the D, the Fund Midcap ETF 15 percent, 13 percent, 12 percent compared with those bonds down there that are 3.8 percent and 4 percent. That is where I want to go.

The average person looks at that, and they say, "Wait, well, of course, why be dumb? I want to put that in there. I get the biggest rate of return right there, 15, 13, and 12 percent average rate. Wow, boy, that is where I would want to go." I mean, that is just the average person, I would think, would look at that. I mean, what else would they need to know other than that?

Mr. CAMPBELL. Well, I think that that goes to exactly the point that Senator Enzi made about the importance of education and ensuring that participants can understand the relative merits of these, and that is an issue that we were trying to address in this model disclosure so that workers would have in one place the information they need to make those judgments.

I think the point that the Senator is making goes to issues of diversification, and should you put all your eggs into one basket? I think those are the sorts of issues that, for example, the PPA addressed in the quarterly benefits statement requiring basic education information and diversification materials.

Senator HARKIN. I think Senator Enzi is on to something here on software. My older daughter said to me one time, not too long ago, "You still using that credit card of yours?" I said, "Yes, I have been using it for years." She said, "Oh, that is not good. You should get a better card, get better deals." And I said, "Well, I never thought about it."

There is a site you can go to. I don't recall the name of it. So I went online, and got on that site. They have a form that you fill out. You tell about who you are and what you do, and how much money you earn, and family information, and they come up with a program of what might be the best credit card for you.

It seems to me, as was said, if they can do this with iPods and music, why can't we come up with a software program when an individual would sit down and plug in a lot of information as to family size, their age, their health, other savings they may have, other resources they might have, job history, perhaps even looking ahead—how many different kinds of jobs—what is their income level and what is their prospectus. You plug in information like that.

Now some of that is sort of by guess and by golly, but people can have a pretty good idea of what they are going to be doing and how much money they are going to be making and what their situations are at that point in time. You plug that in, and back comes a program that says, you know, with all that information you have given us, here is probably what you ought to be thinking about investing in.

Why can't we come up with a software program like that?

Mr. CAMPBELL. Well, fortunately, the Pension Protection Act has finally removed some barriers that prevented exactly those kinds of software programs from being more widely available in plans. Actually, the department just in the last month issued a proposed regulation to implement those provisions. So we are working quite diligently to do exactly that because I think those are very wise decisions that Congress made and an excellent suggestion.

Senator HARKIN. Will that be part of your final rule, to come up with that kind of software program? Could the Department of Labor, EBSA, come up with a model software program?

Mr. CAMPBELL. The regulation I had mentioned in my opening statement is what is addressing this in investment advice. The Pension Protection Act does not specify that the Labor Department create the model. It does require the Labor Department to determine the qualifications of a person eligible to certify the independence of such a model created by another.

I think the intent in Congress was to ensure that we weren't fixing in law and in regulation a static model that doesn't reflect changes that occur, which I think was a wise decision. Our proposed regulation will implement those provisions, and once finalized, that regulation will enable this computer model advice to be available to participants.

So I am very excited about that regulation as well, and I would be happy to discuss it.

Senator HARKIN. I am just trying to think who is going to come up with this model software program.

Mr. CAMPBELL. Typically.

Senator HARKIN. You would want someone divorced from the business. You would want some independent group or some independent agent to do that, I would think.

Mr. CAMPBELL. That certainly occurs currently. Also in the PPA, the requirements would allow various proprietary models to be developed. But they have to be certified that they are unbiased and independent, that the advice they produce is independent.

Senator HARKIN. Yes.

Mr. CAMPBELL. The provisions in the PPA were very wise, and I think our regulation accurately is implementing them. Our proposed regulation would accurately implement them.

Senator HARKIN. I still wonder who is going to come up with the software. It costs money to do something like that, and you wouldn't get any return on it. I mean, this is just information unless someone came up with it and it was just widely adopted by all of the plans. I suppose they could pay a fee to use the software or something. I don't know——

Mr. CAMPBELL. The intent of the provision in the PPA that makes it more widely available is that by removing some of the barriers in law, it allows service providers to offer the investment advice along with other offerings, which previously was quite difficult to do and, thus, makes it a more common feature in plans.

Senator HARKIN. One last question. Do you know how much you pay into TSP, what your fees are in TSP?

Mr. CAMPBELL. Generally, the fees in the TSP are quite low. They range between 1, 2, 3 basis points. Unfortunately, that is not quite an apples-to-apples comparison with the private sector. For one thing, the Federal agencies absorb a great deal of the payroll and other costs that are associated with private sector plans, which factor into the fees that are paid by those plans. So it is not quite apples-to-apples.

Of course, also the TSP is very large. So it does have economies of scale that aren't available to smaller businesses.

Senator HARKIN. There is a lot of difference between 3 or 4 or 5 basis points and 100 basis points or 200 basis points that are out there. It raises also the question of pooling. You might have small entities out there, but why can't they be pooled?

Mr. CAMPBELL. One of the strengths of our private benefit system has always been its flexibility. It allows the workers and the employees in a given employment situation to come up with benefits that best suit them and their unique circumstances.

One of the questions, I think, in a pooling arrangement would be to what extent is that strength diminished by Government-imposed regulations or one-size-fits-all products. I think that has been a concern that I would have in looking at that.

But I think one of the biggest significant impacts of the regulations we have proposed is that by making this a more transparent marketplace, by ensuring that fiduciaries see revenue-sharing arrangements and know exactly what the service provider is getting, that it puts the fiduciaries in the position of being able to accurately and more—to have the information they need to actually negotiate with service providers and understand what is being paid, which protects participants.

In turn, with participants having fee information, it provides feedback the other way to the plan fiduciaries, because the workers now have the tools they need to ask questions of their own plans. And I think there is important feedback that will be provided by these regulations that will have a downward effect on prices.

Senator HARKIN. When do you expect the final rules to be out?

Mr. CAMPBELL. We expect to issue the final fiduciary disclosure regulation in the next several months and the participant fee disclosure regulation by the end of the year.

Senator HARKIN. I hope you are seriously taking into account the information from AARP and looking at what they have come up with, too.

Mr. CAMPBELL. We will very seriously consider all the comments we have received. We are big believers in the notice and comment process at EBSA because it has been very valuable to us in all of our regulations to get that expert input.

Senator HARKIN. Thank you very much, Mr. Secretary.

Senator Enzi.

Senator ENZI. Thank you.

I am going to go to a little bit more basic question to start off because there are many families and individuals that are watching the capital markets right now, and they are worried about the safety of their retirement investments altogether. Are our workers' 401(k) accounts safe? And what should workers be doing to invest for the long-term retirement security, any advice for people at this point in time?

Mr. CAMPBELL. Certainly. I would say our 401(k)s and other long-term savings vehicles are very safe. They are designed to be that way.

The assets in your 401(k), the assets in your traditional pension plan, these are separate and held separately in trust from the assets of the company. So even if your employer goes bankrupt, your retirement is separate from the employer and, therefore, safe from the problems they may have.

Traditional pension plans have an insurance factor from the Federal Government. The SEC, through a variety of mechanisms, has guarantees up to $500,000 for securities that are held by brokers and so forth. So there are a variety of protections in place that make retirement savings vehicles very secure.

I would urge people not to react precipitously. You are investing for the long-term. You should continue to make your regular contributions every payroll period and not be spooked into making radical adjustments but think about what is the best way to get to your ultimate retirement goal.

Personally, for my own account in the Thrift Savings Plan, I am continuing to invest in the C Fund on the grounds that I am dollar cost averaging. And hopefully, when things come back up, I will own more shares that I purchased at a lower price. But hopefully, time will prove me right about that.

Senator ENZI. We have been working on the financial literacy thing for a long time with all of the agencies, and it is something that people have to concentrate on. There aren't a lot of sources out there.

You mentioned the Pension Protection Act several times, and I greatly appreciate all of the time and effort that you and your employees have extended to bring that law to life. One important part of the law was to reduce the hoops that companies had to jump through in order to provide automatic enrollment in 401(k) plans, and the initial numbers from the Employees Benefit Research Institute shows this is really making a difference and is helping get more employees enrolled to save for their retirement.

However, as you heard in my opening remarks, only a quarter of the small businesses are offering 401(k) type plans for their employees. As a former small business owner, I know it is difficult to offer benefits. What are the messages that you have received from small businesses in the comments and letters and your outreach efforts?

In addition, how did that influence the disclosure requirements that you put in the regulatory proposal?

Mr. CAMPBELL. Well, the regulation, particularly in disclosures by service providers to plan fiduciaries, really is primarily a boon for small- and mid-sized companies because these are the fiduciaries that have traditionally had the most difficult time getting the information they really needed because they didn't have the negotiating clout that, for example, a 200,000-person firm would have in negotiating with those same vendors.

By requiring this information to be provided to all fiduciaries, we are ensuring that fiduciaries know what revenue-sharing arrangements are occurring, really know whether there is a conflict that they should be concerned about when one fund is recommended over another, and I think will very much help small businesses and mid-sized businesses in offering plans and offering them on good terms in fulfilling their fiduciary duties to offer very reasonable prices to their workers.

Investment advice I think is also important. Under the PPA provisions, that can now be a service that is more widely available as part of a package of services that a provider would provide, for example, a small business, which typically goes to a single provider for most of the services connected with their plans. That can be valuable to their workers, but also to the small business owners in terms of their own plan. So there is an incentive there.

We also, of course, offer a great deal of education and outreach, working with small business owners to make sure they are aware of their fiduciary responsibilities under the law. I have received many positive comments about the sessions that we have held and the materials that we produce, which are intended to be understandable and useful, and that is something we work on regularly.

Senator ENZI. Several times you have used the words "fiduciary responsibility." To the small businessman, that translates into "liability and lawsuit." What are you doing to counter that, to give them some confidence that if they go with a 401(k) plan, they are not just asking for more lawsuits?

Mr. CAMPBELL. Right. Well, I think the Pension Protection Act was important in helping clarify some of those roles, particularly, as you said, in automatic enrollment. The Department of Labor issued a regulation regarding what sorts of investments are appropriate to be used and that would not carry with them undue liability for workers to be automatically enrolled in, but that would also provide workers with the type of long-term retirement savings returns that are appropriate. That's in the best interests of workers and also the plan sponsors.

In our educational efforts, we make sure that fiduciaries are aware of where the common pitfalls are. The best way to not have a problem is to avoid making a mistake in the first place. And if we can use our experience in the violations that we have seen on our enforcement side to inform our educational side, we can steer plans clear of the common pitfalls, and that is to the benefit of everyone in the system.

Senator ENZI. Well, that is why I am hoping that we will have some more technology involved in this. And when the technology is approved, those using it won't be held responsible so that they can encourage their employees to use that relatively lawsuit free.

Mr. CAMPBELL. I think that is important. The independent certification in the computer model is ensuring that those who then use it can rely on it to be unbiased.

Senator ENZI. Thank you. I have used my time.

Senator HARKIN. Thank you, Senator.

Secretary Campbell, thank you very much.

Mr. CAMPBELL. Thank you, sir.

Senator HARKIN. Good job. Our second panel, Olena Berg Lacy, Director and Senior Advisor for Financial Engines, testifying on behalf of the Pension Rights Center; R. Theodore Benna, Founder of the 401(k) Association, Jersey Shore, PA; Paul Hunt, President, Millennium Advisory Services, testifying on behalf of the U.S. Chamber of Commerce.

We have everyone here, and again, all your statements will be made a part of the record in their entirety. I am going to ask if you could each sum it up maybe in 5 minutes, I would sure appreciate that. We will start, again, with Olena Berg Lacy from the Pension Rights Center.

Ms. Lacy, welcome to the committee.

STATEMENT OF OLENA BERG LACY, DIRECTOR AND SENIOR ADVISOR FOR FINANCIAL ENGINES, TESTIFYING ON BEHALF OF THE PENSION RIGHTS CENTER, WASHINGTON, DC

Ms. LACY. Thank you, Mr. Chairman, Senator Enzi, and other members of the committee.

I appreciate you inviting me here this morning to talk about this very important issue of 401(k) fee disclosure. My name is Olena Berg Lacy, and I was the head of the Employee Benefits Security Administration during the Clinton administration. So I have some familiarity with these issues.

I am also a member of the board of directors of the Pension Rights Center, and as you mentioned, I am representing them here today.

I am going to address the issue of fee disclosure from the perspective of participants. Now while I was at the EBSA 10 years ago, we held hearings on fees and produced a report as a result of those hearings. So I recently went back to look at that report to see what had happened in the interim, and not much actually had until the department undertook its regulatory efforts.

The only thing that has really changed is that there is substantially more assets in plans that are subject to these fees. Fees are important because, as you have already pointed out, millions of people depend on the 401(k) as the primary supplement that they will have to Social Security in their retirement, and fees greatly affect the level of assets people are able to accumulate.

They are also important because of the magnitude of dollars involved. If you look at all defined contribution plans, there are somewhere around $3 trillion held in these types of plans. And if you made a rough assumption that they were collectively managed for 100 basis points, or 1 percent, that means there is somewhere around $30 billion a year going into fees and out of retirement savings accounts.

Disclosure of these fees is a critically important consumer issue. And that disclosure, as you have pointed out, has to occur at two levels. It has to occur at the plan sponsor level, so the plan sponsor is able to make the decisions that they need to, to ensure that they have complied with their fiduciary duty to make appropriate choices for their plan participants. There needs to be disclosure to participants that is clear and concise and easy to understand.

Let us start with disclosure to plan sponsors. Large employers probably have the resources to shop around among service providers, get the information they need, and do the analysis to get the best deals for their plans. But many smaller plan sponsors don't have the ability to do this. They may not know the options that are available to them or even how to evaluate those options.

And fees do vary substantially for very similar investment products. So it is important that they have this information. Currently, there is no explicit legal obligation for service providers to give them that information.

As Secretary Campbell has just discussed, the EBSA undertook a regulatory project to provide that kind of information to plan sponsors, the information that they will need to make prudent decisions. I could spend a lot of time commending all the good things that they have done, but since my time is limited, I would like to focus on the areas where they might not have gone far enough.

One failure, I believe, in the proposed regulation is that the DOL is not requiring that service providers unbundle their fees or separately report different kinds of fees. I think without this unbundling it is going to be difficult for smaller plan sponsors to make comparisons among different offerings.

The DOL report 10 years ago pointed out that there are 80 different ways these fees can be displayed, and also aggregating fees can disguise potential conflicts of interest, and I go into that in my written testimony in greater detail. I believe we need congressional action that goes beyond the DOL proposal.

As I mentioned earlier, the second level of fee disclosure is from sponsors to participants. If participants can determine that the fees they are paying are excessive, they often have the ability to influence the plan design by making their desires and wishes known to their employer. They need clear disclosure as well, and they need to know what they are paying for and how to select wisely among the options that are offered to them.

The DOL, again, has proposed regulations to address this disclosure. And again, I applaud their efforts but believe, as in the case of plan sponsors, they could have gone a bit further. I think the same disaggregation needs to occur at the participant level, perhaps not in the same detail as plan sponsors will need, but some separation of fees into the basic categories of services.

Now there are other issues with the proposed regulations as well. Senator Harkin, in your question, I think you got to the heart of it. The chart has both fees and performance, and I believe performance data was put in probably because the department heard from a lot of people, that if you just give participants fee data, they will go for the lowest. They need to know performance as well.

That performance chart has no mention of risk. And I think it is a far greater harm if people go to the riskiest funds because they appear to provide the most return than it is if people go to the lowest fee.

I will be happy to answer any questions that you have and quickly point out that with another hat, I sit on the board of directors of a company that provides exactly the software you have been talking about, and I would be happy to brief you on that at any time.

[The prepared statement of Ms. Lacy follows:]

PREPARED STATEMENT OF OLENA BERG LACY

Thank you, Mr. Chairman and members of the committee, for inviting me here to speak to you about the important issue of fee disclosure to 401(k) plans and their participants. My name is Olena Berg Lacy and I was head of the Department of Labor's Employee Benefits Security Administration (EBSA) during the Clinton administration. I am also a member of the board of directors of the Pension Rights Center, which I am representing today. The Center is a nonprofit consumer organization that has been working since 1976 to promote and protect the retirement security of American workers and their families. I would like to address the fee issue from the perspective of what level of disclosure is in the best interests of plan participants.

While I was with EBSA, we held hearings on 401(k) fees in November 1997 and issued a report in April 1998. I recently went back to review that report and see what had changed since. I am sorry to say that not a lot has changed in the intervening decade—except that substantially more assets are in plans that are subject to these fees.

Of course, the major development that has occurred in the last decade is the increase in the shift from defined benefit plans to defined contribution plans so that increasingly a DC plan—a 401(k), a 457, or a 403(b)—will be the only or the primary supplement to Social Security for millions of workers.

Fees are important. We cannot predict future returns on investments, but fees are a certainty. They can make a substantial difference in a retirement account balance. The Government Accountability Office has pointed out that a 1 percent increase in fees on an account achieving a 7 percent rate of return annually will reduce retirement savings by 17 percent over 20 years. The impact of fees is greater still on smaller account balances or over a longer period of years.

Fees are also important because of the magnitude of dollars involved. More than $3 trillion is invested in these plans. If you assume that collectively, they are operated for just 100 basis points (1 percent), that amounts to more than $30 billion per year taken from retirement saving accounts in fees. The significance of this loss of retirement income is greatly magnified when markets are in turmoil and participants are incurring losses in their accounts.

For fee disclosure to truly benefit plan participants, it must occur at two levels: disclosures from service providers to plan sponsors on fees assessed to the plan, and from plan sponsors to plan participants on the fees participants are paying. Disclosure to sponsors at the plan level is critically important to participants because it is the sponsor who makes the determination of what services to provide and what investment alternatives to include in the plan. The sponsor has a fiduciary duty to ensure that these decisions are made prudently and for the sole and exclusive benefit of the participants.

You might expect that in order to fulfill this duty, plan sponsors would simply "shop" among service providers to find the best deal for their plans. In the large plan market, this is largely the case. But as the DOL report pointed out in 1998, the market is not efficient in allowing small- and medium-sized plan sponsors to be aware of what is available to them. They have difficulty in getting the information they need to make informed decisions. Because fees vary substantially for very similar investment products and services, it is critical that such information be provided but there is no explicit legal obligation for service providers to do so. In the absence of such a requirement, sponsors are on their own to sort out fee information. As the DOL study pointed out, there are more than 80 ways fees could be displayed. This is because there are different types of fees: asset-based, per participant fees, and itemized fixed charges. There are also different categories of fees, such as administrative costs, communications, investment management and sales charges. Many of these categories have subcategories.

Given the lack of information available and the confusing array of ways in which it is presented, it is reasonable to ask if some plan sponsors are selecting investment and service options with excessive fees. While there is not a lot of data, a 2007 study might be indicative. IMC, a consulting firm, examined the offerings of thousands of plans of all sizes and different categories of investment offerings. Based on their findings and extrapolating what they found to the entire market, they estimated that as many as 5.5 million of more than 55 million participants may be paying some unreasonable fees, and the assets subject to these fees total almost $300 billion. If you add in plans paying some high fees, 26 percent of total assets may be subject to high or excessive fees. In small plans with under $5 million in assets, almost 50 percent may be paying some high or excessive fees.

In general, large-plan sponsors have the ability to issue RFPs to numerous service providers and to demand that information be provided in a consistent format so that comparisons may be easily made. They have the sophistication to evaluate the information they receive. Small-plan sponsors probably do not. In fact, the DOL report noted that surveys showed that cost was not a primary consideration for them and that, in fact, many select as their 401(k) provider financial institutions that provide them with other financial services. Yet these sponsors have the same fiduciary duty to make these decisions for the sole and exclusive benefit of plan participants.

To level the playing field, it is important that explicit disclosure requirements exist for the information that service providers must provide plan sponsors and that there be uniformity in the format so that comparisons are easy to make. The EBSA undertook a regulatory project earlier this year to effect such requirements and should be commended for undertaking this important effort. Its proposal provides much-needed information to plan sponsors to allow them to make reasonable decisions. Unfortunately, the proposed regulations do not go far enough.

Most importantly, the DOL failed to require that expenses be unbundled.[1] Without separation of fees for the different categories of investment management, plan administration, and participant services, it will be difficult, if not impossible for small- and medium-sized plan sponsors to make comparisons among different offerings. And as they monitor the reasonableness of the fees they pay, without unbundling, they will be unable to determine if investment managers and other service providers are reaping windfalls when the growth in assets subject to an all-in management fee exceeds the incremental costs of providing administrative and other services.

Aggregating fees can also disguise potential conflicts of interest. For example, assume there is a plan with 15 different investment offerings, but the record-keeper is getting 65 percent of its revenue from just one or two of those offerings—and those are proprietary offerings. If the funds under-perform, the record-keeper may well resist removing them from the investment line-up because of the difficulty in replacing that lost fee revenue.

Also, if regulations or legislation were to allow aggregate-level disclosure, we would be concerned that plan sponsors might assume that their duty to examine fees extended no further than what was required to be revealed to them. In reality, ERISA requires that they ferret out such conflicts of interest. And they need sufficient information to do so.

It is vital that we get this right and there is a need for congressional action to go beyond the DOL proposal.

As I mentioned earlier, the second level of disclosure is from plan sponsors to plan participants on the fees they are paying. In discussions about this issue, I have noticed that even those who support better disclosure to plan sponsors are less willing to concede that greater disclosure to participants is also needed. I respectfully disagree. Plan participants also have important decisions to make that such disclosures would support. The first critical decision is whether to participate in the plan in the first place. Most participants to not contribute anywhere near the maximum annual limit and many do not contribute enough to maximize the company match. Many lower-wage workers do not even contribute beyond the IRA limit and may well be better off with an IRA if the costs of operating the 401(k) plan exceed the value of the company match.

Furthermore, participants often have the ability to influence plan design and investment offerings by making their desires known to their employer. So they need to understand what they are paying for. The DOL study posed it this way: "If participants knew how much optional features of their plans cost, would they demand so many?" An Internet study showed that 85 percent of 1,000 respondents voted for greater investment returns versus more services from their plans.

Again, in addition to plan features, participants may influence which investment options are offered. And certainly they need fee comparisons to select among those options.

The DOL has also undertaken a regulatory effort to address disclosure to plan participants and recently issued proposed regulations. By requiring a single, tabular description of fees to participants, the department's proposal will significantly improve the transparency of fees. However, as with the DOL's approach to service provider disclosure to plan sponsors, these regulations fall short. Indeed, one can assume that if the plan sponsor disclosures are inadequate, they will not be conveyed to participants in a way that is meaningful and can be easily understood. The information should be unbundled at the participant, as well as the sponsor level. While participants may not need the same level of disaggregation of fees that plan spon-

[1] 401(k) plan fees and expenses generally fall into three categories: plan administration fees, individual service fees, and investment fees. Some employers may provide for or negotiate these services separately and the expenses charged by each provider (recordkeeper, investment manager, etc.) are charged separately. This is referred to as an "unbundled" arrangement. In the case of unbundled arrangements, the proposed regulations require that the dollar amount of plan administration fees be disclosed to participants in quarterly benefit statements. Other plans may have some or all of the services offered by one provider for a single fee and that provider will then pay out of its fee any other service providers it may have contracted with to provide services. This is a "bundled" arrangement. The proposed regulations do not require disclosure of plan administration fees in bundled arrangements.

sors should have, at the very least, fees for the different categories of services should be separately disclosed.

For disclosure to participants to be helpful, it needs to be clear, concise, and readily accessible. Financial terminology needs to be explained in simple terms. The regulation as proposed does not require sufficient explanation of either fees or investment choices. While too much information may overwhelm participants, too little will not support reasonable decisionmaking. And the information must be presented using terms that most participants will understand. Effective disclosure also requires easy access to the information. Electronic means of disclosure will not be appropriate for participants without access to computers or knowledge of how to use them.

There are other issues with the proposed regulations, as well. They require the provision of summary investment performance information. This requirement is undoubtedly in response to the concern expressed by many industry observers that the provision of fee information only might lead some financially unsophisticated participants to opt for the lowest fee funds without regard to performance. Unfortunately, the summary performance information could result in a similar problem with this group of participants: that they opt for the highest performing funds without regard to risk. We submit that this is a far greater danger and, if it cannot be averted, the fee information should stand alone.

Finally, in some respects, the proposed regulations weaken currently required disclosures. (Please see the attached letter from the Pension Rights Center to the DOL commenting on the regulations for more detail). So as with disclosure to plan sponsors, there is a need for Congress to step in.

I mentioned at the beginning of my remarks that not much has changed in the last decade. But there is some new evidence that just your interest in this issue is making a difference. A recent article in *Investment News* reported on a survey that showed that 30 percent of plan sponsors cited costs and fees as their reason for switching plan providers. This marks a significant change from the last survey in 2005, when only 18 percent changed for this reason. The article mentioned that discussions in Congress, as well as the recent DOL activity, has brought the issue of fees to the forefront. We believe that without further congressional action, this momentum could fade. So we thank you for holding this hearing and for your interest in this issue of paramount importance to the retirement well-being of millions of American workers.

PENSION RIGHTS CENTER,
WASHINGTON, DC 20036,
September 8, 2008.

OFFICE OF REGULATIONS AND INTERPRETATIONS,
Employee Benefits Security Administration,
Attn: Participant Fee Disclosure Project, Room N–5655,
U.S. Department of Labor,
200 Constitution Avenue, NW,
Washington, DC 20210.

Re: Comments on Proposed Regulations on Fiduciary Requirements for Disclosure in Participant-Directed Individual Account Plans

We are submitting comments on the Department of Labor's proposed regulations for fiduciary requirements for disclosure in Participant-Directed Individual Account Plans. The Pension Rights Center is a nonprofit consumer organization that has been working since 1976 to promote and protect the retirement security of American workers and their families.

As the Department of Labor noted in its preamble to the proposed regulations, and as the Department of Labor's Advisory Council on Employee Welfare and Employee Retirement Plans noted in a 1998 report on fees in defined contribution plans, high fees can have a substantial negative effect on an employee's retirement savings in a defined contribution plan. And the evidence is strong that in many defined contribution plans, particularly 401(k) plans sponsored by small and medium sized firms, fees exceed reasonable levels.

The proposed regulations create a new regulatory regime for disclosing fees and investment performance information to participants. While we think that the proposal springs from good intentions and incorporates some sound ideas, it is, in many respects, problematic. The regulations will not ensure that adequate information is provided to participants to help them make intelligent decisions on how to invest plan assets, or, indeed, whether to participate in the plan at all. Moreover, the regulations provide some information that may mislead the typical investor, resulting in some investors making poorer, rather than wiser, decisions. In addition, the regulations fall short on providing participants with sufficient information to evaluate the performance of the fiduciaries responsible for selecting investment alternatives and negotiating fees with third parties.

Our specific concerns include the following:

1. *The regulations should require that fees be unbundled.* The regulations' most significant short-coming is that they do not require that fees for broad categories of services be separately stated, but rather allow fees to be bundled.[1]

Particularized information about the nature and size of fees is critical to responsible investing. When fees are bundled, however, participants are denied this information. Fee unbundling is critical to providing participants with the information they need to choose among investment alternatives (and decide whether to participate in the plan). Moreover, with bundled fees, a plan record keeper may be able to overburden non-proprietary funds with excess fees, making its proprietary funds more attractive. Bundled fees may thus result in participants who invest in certain investment alternatives subsidizing the recordkeeping and other fees of participants who invest in other alternatives.[2]

Bundled fees also mask the cost of particular services, some of which might not be used by most participants. If the costs of such services were more transparent, participants might ask the plan sponsor to drop the services or charge the costs of the services directly to the participants who use them. Finally, when administrative services are bundled with investment fees, it becomes more likely that vendors of investment vehicles will reap windfalls when asset growth exceeds the incremental additional costs of providing administrative services.

We are aware that to provide this information it will be necessary for investment vendors who currently bundle fees (or who receive revenue sharing or similar payments from other parties) to modify their current business practices. But such transitional costs for vendors do not seem too large a price for the vendors' ability to participate in one of the largest investment markets in the world, and it is reasonable to require that market participants play by rules that maximize transparency. We also know that there are technical issues involved in requiring that fees be separately stated, but we believe that the Department of Labor should be able to draw on the considerable investment expertise of other Federal agencies and the private markets to create a workable regulatory regime in which fees for broad categories of services are separately stated.

It is also worth observing that some observers have suggested that the proposed regulations, by requiring greater transparency when fees are not bundled, will result in more plans contracting with vendors who bundle fees. This would further undercut efforts to improve transparency.

2. *Plans in Which Participants Do Not Have Investment Choice.* The proposed regulations require disclosure to participants in plans where employees allocate their accounts among several investment alternatives, but do not apply to plans where the investments are professionally managed for the participants as a unitary group. But participants in the latter plans also have a need to know the investment and administrative fees for which they are paying, to assist them in their planning for retirement and to evaluate fiduciary performance. The regulations should extend fee disclosures to participants in such plans.

3. *Description of Investment Information.* The proposed regulation requires the provision of summary investment performance information. This requirement is undoubtedly in response to the concern expressed by many observers that the provision of fee information only might lead some unsophisticated participants to opt for the lowest fee funds without regard to performance. Unfortunately, the summary performance information could result in another problem with this group of participants: they may opt for the highest performing funds without regard to risk. We submit that this is a far greater danger and if it cannot be averted, the fee information should stand alone. In fact, the required disclosure fails to provide even sum-

[1] 401(k) plan fees and expenses generally fall into three categories: plan administration fees, individual service fees, and investment fees. Some employers may provide for or negotiate these services separately and the expenses charged by each provider (record keeper, investment manager, etc.) are charged separately. This is referred to as an "unbundled" arrangement. In the case of unbundled arrangements, the proposed regulations require that the dollar amount of plan administration fees be disclosed to participants in quarterly benefit statements. Other plans may have some or all of the services offered by one provider for a single fee and that provider will then pay out of its fee any other service providers it may have contracted with to provide services. This is a "bundled" arrangement. The proposed regulations do not require disclosure of plan administration fees in bundled arrangements.

[2] It should also be noted that unbundled fees would permit fee disclosures to include benchmarks for different types of fees.

mary descriptions of each alternative or notation of the level of risk associated with each investment.

While we agree that furnishing participants with excessive information can be counterproductive, this does not mean that the optimal level of disclosure is the least disclosure. We do not see how participants who are unwilling or technologically ill-equipped to search Web sites for information on each of their investment alternatives are served with the scant summary information required by the regulations. Indeed, the regulations, seem to adopt a name, rank, serial number approach to disclosure: they require written disclosure for each investment alternative of only the following: (1) category of investment, (2) form of management (passive or active); and (3) historical performance data (with a market benchmark). This is insufficient and may result in some investors selecting the investment with the highest historical return—without regard to risk or the value of portfolio diversification—since this is what the disclosure statement appears to isolate as the key determinant of the value of an investment. We note that the Federal Thrift Savings Plan provides understandable summary paragraphs for each investment alternative and might be a starting model for better disclosure than the proposed regulations would require.

We also recommend that if performance data is included in the final regulations, the regulations specify that investment return be reported net of fees.[3] In addition, there should be a requirement that key terms such as expense ratio, basis points, large-cap fund, operating expenses, active management and passive management, etc., be clearly defined.

4. *The Regulations Should Not Reduce Investment Disclosure.* The regulations currently in effect under ERISA § 404(c) require that a prospectus be provided to participants for each investment alternative offered by the plan. The proposed regulations, which would replace these rules, do not require provision of prospectuses. Instead, they merely require plans to provide information on how to access prospectuses on the Internet. Many participants are more likely to read a prospectus if they are provided with a hard copy than if they must access the Internet. We urge that the new regulations focus on improving disclosure rather than weakening it.

5. *Expenses Charged to Individuals.* The regulations require that expenses charged directly to individual participants be disclosed. We think it probable that some participants will not understand the significance of some of these charges. We thus believe the regulations should provide information to help individuals understand the nature of the charges and the impact they can have on return. As an example, we note in the sample disclosure chart in the regulations, that one investment imposes a $20 annual service fee on accounts with less than $10,000. The average return for this fund over the previous 5-year period was .22 percent and 8.9 percent for the previous year. If a participant had invested $1,000 in this account and the fund returned on average 2 percent annually over the next 5 years, the account balance would not have grown at all during this period. And if the returns during this period were initially lower than 2 percent, the return would have been negative over those 5 years, notwithstanding the 2 percent average rate of return. We do not think this will be apparent to many participants. In addition, we are skeptical that all participants are aware of how, for example, a "4.25 percent deferred sales charge against amounts invested or redeemed," might affect their investments.

6. *Correlation of fee disclosure and investment disclosure.* The typical participant reading the Model Comparative Chart would not know whether the "average annual total return" for a fund on Part I reflected the fees separately stated on Part II (both annual operating fees and shareholder and shareholder-type fees).

7. *Timing and Method of Disclosure.* The proposed regulations permit general fee and investment disclosure to be made in a plan's summary plan description and require that modifications to the general disclosures be made by the 30th day following the adoption of a material change. While providing information in the summary plan description is useful, we believe that providing a stand-alone disclosure to participants when they first commence plan participation, and annually thereafter, would better serve participants and put only a mild additional burden on plan sponsors. We also believe that material changes in fee and investment information should be reported to participants before, rather than after, they are adopted.

Finally, we want to note that promulgation of a regulation on fee disclosure requires two conceptually distinct inquiries: first, what information does a participant

[3] The definition of "average annual total return" refers to Securities and Exchange Commission Form N–IA, which requires that investment performance be disclosed net of fees, but since some plan fiduciaries may not be familiar with the SEC requirements, the fact that investment return must be shown net of fees should be made explicit in the final regulations.

require about fees to make informed investment decisions; and second, how the information can be made intelligible to participants. The latter inquiry can be most effectively answered through testing various alternatives with actual participants. We urge the Department to undertake such a study.

Respectfully submitted,

NORMAN P. STEIN,
Policy Advisor.

JANE T. SMITH,
Policy Associate.

Senator HARKIN. All right. We will come back to that.

Next, we will turn to R. Theodore Benna, founder of the 401(k) Association, who I am told is the parent of 401(k)s.

Mr. Benna, welcome. I often wondered who dreamed this whole thing up.

STATEMENT OF R. THEODORE BENNA, FOUNDER, THE 401(K) ASSOCIATION, JERSEY SHORE, PA

Mr. BENNA. Thank you. Well, it's a pleasure to be here, Mr. Chairman and Congressman Enzi.

I appreciate the opportunity and want to comment just briefly on the fees, but more importantly, I think, about other issues that tie into it, which you were both addressing, and that is participants making wiser investment decisions and burden of liability placed on employers.

Definitely greater disclosure is required to plan sponsors and participants. This is a very high-level frustration for both of those audiences. So action clearly is needed.

On the other side, being involved in the administration of small plans for small businesses, I have to warn you that it is not easy to obtain the information that you are asking to be disclosed. It is extremely difficult to find the information due to the many layers of fees that exist.

On the investment side, the fact that funds that are offered in these plans can be—there are many different share classes that are involved. There is no easy way to go out there, gain the fee information and the investment return information, and provide it.

My best estimate in terms of having to do that in our little business is it probably would result in having to increase fees to our clients by 5 to 10 percent to be able to pull that information together. Certainly one of the things that would be very helpful to the industry would be some centralized place because everybody who has a plan and is servicing them would have to disclose fees. Right now, there isn't one easy place where you can go to and find performance information and fee information for all share classes that are readily available that I know of.

That is my comment on fees. I want to comment on your concern about participant investments. It is probably about 7 years ago now, when we were coming up to the 25th anniversary of the first 401(k) savings plan, that I was focusing on the fact that we have a lot to learn from the experience we have gained. One of the things that frustrated me was the fact that despite millions of dollars thrown at education, it hadn't really changed the bar.

I helped, as Olena did, launch the investment advice business with computer-driven models and had the hope that that was going to help overcome this hurdle of participants making better investment performance. After a couple of years' experience watching that model, I concluded that it wasn't doing any more than what education did to change the way participants were investing.

At that time, Money magazine ran an article. The title of the story was "Fixing 401(k)." I had a quote in that, which was a one-liner, which was, "The father of 401(k) said if he were starting over from scratch today, he would blow up existing investment structures." That got a little concern in the investment community, I might add.

What I was talking about were two things that you are both obviously focusing on. That is getting participants to understand and to make easier decisions, and the question I was asking is why should employers be liable, have a gun held to their head being fearful of being sued when they are helping their employees save for retirement? It doesn't make sense.

At that time, I started talking here and visited some different people and promoted the idea of a fiduciary safe harbor that would protect businesses who chose to structure their plans in a certain way from liability exposure. The investment structure I was talking about at that time, frankly, was replacing these big menus that we throw out at participants and expect them to be able to understand and make informed investment decisions about and to use vehicles that are already in place that provide proper allocations, automatically re-balance, and automatically reduce risk as participants grow older.

Those investment vehicles are commonly known as target maturity funds. Seven years ago, there was only one mutual fund company that offered those funds. Today, every player in the field must offer them due to the demand and the awareness that these funds are achieving a lot of the things that you are looking to accomplish.

PPA included a provision in it that reduces fiduciary liability potentially for employers who utilize funds of this type, and that was put in primarily for default investment purposes. However, that application potentially has much broader potential for employers who use that kind of structure and the benefits of QDIA to help their participants get better investment results without having to make all these complex decisions and also substantially reduce employer liability for the employers.

Thank you.

[The prepared statement of Mr. Benna follows:]

PREPARED STATEMENT OF R. THEODORE BENNA

I am commonly referred to as the father of 401(k) because I designed and installed the first plan that used a matching employer contribution and employee pretax contributions. I am semi-retired, but I am still active and have been in the retirement plan business for 49 years,

I am here as an advocate for participants and employers and as a co-owner and officer of a small company that administers plans for small employers.

Substantial progress has been made to disclose fees during the past 10 years due to governmental attention and market pressure. Most employers receive fee information today but many participants either don't or it is available but hard to find.

There is lots of room for improvement.

As a 401(k) advocate, I support the adoption of the Department of Labor proposed regulations but with a delayed effective date. As an officer of a company that administers plans, I am concerned about the time and cost related to complying with these regulations.

A major problem is the fact that there isn't any place where the data is readily available for all mutual funds that may be offered in a 401(k) plan. A community effort to gather this information will be useful.

The effective date is unworkable.

A determination needs to be made regarding who will be responsible for providing the necessary information. Greater disclosure is badly needed but it is questionable how much of an impact greater disclosure will have.

Senator HARKIN. Thank you very much, Mr. Benna.

And now we will turn to Paul Hunt, President of the Millennium Advisory Services on behalf of the U.S. Chamber of Commerce.

Mr. Hunt.

STATEMENT OF PAUL HUNT, PRESIDENT, MILLENNIUM ADVISORY SERVICES, TESTIFYING ON BEHALF OF THE U.S. CHAMBER OF COMMERCE, GLEN ALLEN, VA

Mr. HUNT. Thank you, Senator Harkin. I appreciate being here today, and I want to thank both of you, Senator Enzi and Senator Harkin, for the opportunity to discuss the appropriateness of retirement plan fees.

I am Paul Hunt. I am president of Millennium Advisory Services. We are an SEC-registered investment advisory firm. I am also president of Millennium Capital Management, and we do traditional investment business through our broker/dealer relationship with Triad Advisors out of Atlanta, GA.

I am pleased to testify today on behalf of the U.S. Chamber of Commerce, where I am a member, and I am also a member on their Corporate Leadership Advisory Council.

As you know, the Chamber is the world's largest federation, representing more than 3 million businesses and organizations of every size, sector, and region. Over 96 percent of the Chamber members are small businesses with fewer than 100 employees. So I am a very good representative of the Chamber today because we are a small business.

Also being a small business, we are in the investment world. As investment advisors—we are investment advisors on several retirement plans, and employees of Millennium Capital, through Triad Advisors and are registered reps on several retirement plans. We are also a small business that sponsors our own retirement plan.

I believe it is critically important to discuss the impact of potential legislation on the small business sponsor. For that reason, I appreciate this opportunity to discuss fee disclosure and the potential impact that it may have for small businesses.

While there have been several bills introduced in Congress on fee disclosure and several sets of regulations issued by the Department of Labor, my comments today will focus on general principles and concerns of small business plan sponsors rather than on specific provisions in any one piece of legislation. I would like to highlight the following areas.

Plan fee disclosure can be helpful to small business plan sponsors in the appropriate context. Onerous administrative and cost burdens will negatively affect small business plan sponsorship. Liability concerns are an important consideration for small business owners. And the ability to buy bundled services should be preserved.

First, it is important to state that plan fee disclosure can be very helpful to small businesses. Being in the investment business, we are true believers of transparency, and I applaud what you gentlemen are doing. We believe that transparency is a very, very important factor in the retirement plan world.

Clarification of fee disclosure requirements can be very helpful to small business plan sponsors to ensure that they are aware of the services that they are receiving and the prices they are paying. At the same time, it is critical that the significance of plan fees be put in the appropriate context.

Some plan sponsors may begin to feel that they need to choose the least expensive investment option in order to avoid litigation claims. However, the lowest fees are not a guarantee of the best performance. Moreover, plan sponsors may desire services or features that are not included in the lowest fees. Therefore, it is necessary for plan sponsors to also consider expenses in the greater context of investment performance and features.

As you are aware, small business owners are very sensitive to administrative and cost increases. Due to their size and resources, small business owners often feel these burdens sooner and more deeply than their larger counterparts. Unlike a large company that may have a dedicated human resource or benefits professional, or even an entire department, this function in a small business may be one of several other duties of an employee, more likely the owner.

Therefore, small business owners will be less likely to establish a retirement plan if there are going to be significant administrative burdens that they do not have the resources to cover. The threat of litigation is a serious concern for small business plan sponsors.

While the publicity garnered by congressional hearings, lawsuits, and newspaper articles has highlighted the importance of plan fees, it has also created for some a negative impression of plan fees and plan sponsors. A small business owner who does not have the resources to hire an outside consultant may become wary of offering an individual account plan at all for the fear of a potential lawsuit. Therefore, it is critical to proceed cautiously and thoroughly, consider all implications associated with any changes or requirements.

I am going to make a side comment on that. In my opinion, I think that it is very dangerous because of litigation. I think it is almost a catch-22 for the small business owner. The threat of being sued over not having the lowest expense fees, and then the other side of the coin is, as you know, markets are very cyclical. Different investments perform different in different times, and choosing the lowest cost fee does not provide for protection against cyclicality.

Therefore, I think that the small business owner is also afraid of litigation for not having better performing funds in there and a wider choice. So I think that is something you have to be very careful of.

Finally, we request that Congress let the market determine the services and products available to sponsors. There is a need for support for both bundled and unbundled services. The choice of which service model to use should be made by the consumer, in this case the plan sponsor, based on its needs and resources.

For both administrative and cost concerns, there are employers that may prefer to use bundled services for their retirement plans. In terms of administration, it is one-stop shopping. Furthermore, the pricing of bundled services may be more attractive to some plan sponsors.

Again, for a small business sponsor who is trying to maximize resources, this is an important consideration. Congress should consider the need to increase plan sponsorship in the small business market if it considers any changes to bundled fee arrangements.

In conclusion, the concerns of small business plan sponsors need additional consideration. Unreasonable administrative requirements, additional liabilities and potential cost increases could drive small businesses away from the private retirement system. At a time when small business retirement plans are beginning to experience success, we should encourage these efforts by creating requirements that fully consider the concerns and possible consequences to small business plan sponsors.

I appreciate the opportunity to address our concerns, and I am open for any questions you may have.

[The prepared statement of Mr. Hunt follows:]

PREPARED STATEMENT OF PAUL HUNT, U.S. CHAMBER OF COMMERCE

SUMMARY

The U.S. Chamber of Commerce is the world's largest business federation, representing more than 3 million businesses and organizations of every size, sector, and region.

More than 96 percent of the Chamber's members are small businesses with 100 or fewer employees, 70 percent of which have 10 or fewer employees. Yet, virtually all of the Nation's largest companies are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at large.

Besides representing a cross-section of the American business community in terms of number of employees, the Chamber represents a wide management spectrum by type of business and location. Each major classification of American business—manufacturing, retailing, services, construction, wholesaling, and finance—is represented. Also, the Chamber has substantial membership in all 50 states.

The Chamber's international reach is substantial as well. It believes that global interdependence provides an opportunity, not a threat. In addition to the U.S. Chamber of Commerce's 105 American Chambers of Commerce abroad, an increasing number of members are engaged in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on national issues are developed by a cross-section of Chamber members serving on committees, subcommittees, and task forces. More than 1,000 business people participate in this process.

Thank you, Chairman Kennedy, Ranking Member Enzi, Senator Harkin and members of the committee for the opportunity to appear before you today to discuss the appropriateness of retirement plan fees. My name is Paul Hunt, President of Millennium Advisory Services, Inc., which is an SEC-registered investment advisory firm. I am also President of Millennium Capital Management of Virginia, Inc., which does traditional investment business through our broker/dealer relationship with Triad Advisors, Inc. I am pleased to be able to testify today on behalf of the U.S. Chamber of Commerce where I am a member of its Small Business Council and the Corporate Leadership Advisory Council. The Chamber is the world's largest business federation, representing more than 3 million businesses and organizations of every size, sector, and region. More than 96 percent of the Chamber members are small businesses with fewer than 100 employees.

Millennium Advisory Services is an investment advisor for several retirement plan clients, and employees of Millennium Capital Management are registered representatives on several other retirement plans. We are also a small business that sponsors our own retirement plan.

As a provider of services to small business plan sponsors, I believe that it is critically important to consider the impact of any potential legislation on the small business plan sponsor. For that reason, I appreciate the opportunity to discuss the issue of plan fee disclosure and the potential impact on small business plan sponsors.

INTRODUCTION

According to the U.S. Small Business Administration, small businesses (less than 500 employees) represent 99.9 percent of the total firms and more than half of the workforce in the United States.[1] Clearly, ensuring adequate retirement security for all Americans means encouraging small businesses to participate in the private retirement system. Small businesses, in general, face significant hurdles and may view retirement plans as yet another potential obstacle and therefore, choose not to establish them. Thus, there have been tremendous efforts to provide incentives and encourage small business owners to establish and maintain retirement plans.[2] Consequently, it is important to give special consideration to potential burdens that new legislation may impose on small businesses.

Despite the obstacles, and due to various incentives, small businesses are having success in the retirement plan arena. Small businesses with less than 100 employees cover more than 19 million American workers.[3] Most of these small business employees enjoy generous annual retirement plan contributions from their employers, often in the range of 3 to 10 percent of compensation. Thus, the small business qualified retirement plan system is successful in delivering meaningful retirement benefits for its employees and all efforts should be made to encourage its continued success.

My comments today focus on the concerns of small business plan sponsors as they relate to additional fee disclosure requirements. While there have been several bills introduced in Congress on fee disclosure and several sets of regulations issued by the Department of Labor, our comments today focus on general principles and concerns rather than focusing on specific provisions in any one piece of legislation or regulation. Clarification of fee disclosure requirements can be very helpful to small business plan sponsors to ensure that they are aware of the services that they are receiving and the prices that they are paying. In order to ensure that plan fee legislation helps small businesses, we ask Congress to consider our following concerns.

SMALL BUSINESS PLAN CONCERNS

Costs Considerations are Important to Small Business Plan Sponsors. Of course, small business owners—like all business owners—are concerned about costs. The costs of maintaining a retirement plan may be a greater consideration for a small business owner, because once a small business decides to establish a retirement plan it is often subject to higher administrative fees than larger companies. A report by the Small Business Administration found that the administrative costs for large companies (over 500 employees) averaged $30 to $50 per participant while the administrative costs for mid-size companies (500 to 199 employees) were slightly higher at $50 to $60 per participant. For the smallest companies, however, (200 and fewer employees), the average administrative costs jumped to over $400 per participant.[4] One reason for the higher cost is that there is a minimum administrative cost to establishing and maintaining a retirement plan and small companies have fewer employees to spread the costs over; therefore, the costs per participant can become

[1] U.S. Small Business Administration Office of Advocacy estimates based on data from the U.S. Dept. of Commerce, Bureau of the Census, and U.S. Dept. of Labor, Employment and Training Administration.

[2] Under the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") that was made permanent by the Pension Protection Act of 2006 ("PPA") small businesses may claim a tax credit for establishing a retirement plan equal to 50 percent of qualifying costs up to $500 per year for the first 3 years. In addition, the PPA instituted a number of additional positive reforms including the creation of the Roth 401(k), simplification of a number of complex administrative requirements, and the creation of the DB(k) for small businesses.

[3] Patrick J. Purcell, Congressional Research Service (CRS) Report for Congress, Social Security Individual Accounts and Employer-Sponsored Pensions, February 3, 2005, Table 2. Employee Characteristics by Employer Retirement Plan Sponsorship, 2003 at CRS–5.

[4] Joel Popkin and Company, Small Business Administration, Office of Advocacy, Cost of Employee Benefits in Small and Large Businesses 38 (2005).

significantly higher.[5] Thus, it is critical to keep this distinction in mind when discussing the appropriateness of plan fees.

Moreover, small business plan sponsors have a personal stake in the cost and operation of the plan since they are also generally plan participants. At the start, small business owners typically solicit multiple bids for the contract and ask the potential service providers questions about the plan before signing up for services. Once the plan is established, the small business owner, who is generally also a plan participant, has a vested interest in keeping fees down for both the plan and the participants.

Anticipated Liabilities May Drive Small Business Owners Away from Plan Sponsorship. We should not underestimate the small business owner's concern over additional liabilities (even if they are only perceived). Over the past year, plan fees have been the subject of congressional hearings, lawsuits, and newspaper articles. While this publicity has highlighted the importance of plan fees, it has also created a negative impression of plan fees and plan sponsors. Thus, there is a heightened scrutiny of plan fees. A small business owner who does not have the resources to hire an outside analyst may become wary of offering an individual account plan at all. In addition, some small business owners may have a difficult time obtaining fee information from their service providers in a format that they can easily digest and provide for their participants. The ERISA Advisory Council warned that "a balance must be struck between what can reasonably be expected of small plan sponsors and the potential capabilities of larger plan sponsors."[6] For example, statements that imply that there is an "average" amount for plan fees can be misleading to participants in small business plans for the reasons mentioned above and lead to additional liability for the plan sponsors. Therefore, it is critical to proceed cautiously and thoroughly consider all implications associated with any future changes or requirements.

Onerous Administrative Burdens Will Negatively Impact Small Business Plan Sponsorship. Small business owners are very sensitive to administrative and costs increases. Due to their size and resources, small business owners often feel these burdens sooner and more deeply than their larger counterparts. Small business owners generally have fewer resources and, therefore, have greater concerns about taking on additional administrative responsibilities. Unlike a large company that may have a dedicated human resources or benefits professional or even an entire department—this function in a small business may be one of several other duties of an employee or, more likely, the owner. Therefore, small business owners will be less likely to establish a retirement plan, if there are going to be significant administrative burdens that they do not have the resources to cover.

Bundled Service Arrangements are Advantageous to some Small Businesses. For both administrative and costs concerns, there are employers that may prefer to use bundled services for their retirement plans. In terms of administration, it is one-stop shopping. Rather than dealing with several different service providers, the plan sponsor can deal with only one or two; thereby, maximizing the allocation of his or her resources by minimizing administration responsibilities. Furthermore, the pricing of bundled services may be more attractive to some plan sponsors. Again, for a small business plan sponsor who is trying to maximize resources this is an important consideration. Congress should consider the need to increase plan sponsorship in the small business market if it considers any changes to bundled fee arrangements.

Moreover, as an entrepreneur and member of the Chamber, I believe that services and products should be determined by the market and not by Congress. There is a need and support for both bundled and unbundled services. The choice of which service model to use should be made by the consumer—in this case the plan sponsor—based on its needs and resources. We sincerely urge Congress not to mandate one type of service arrangement over another.

Bundled Service Arrangements are Consistent with Fiduciary Obligations. The fiduciary of the trust (normally the employer) must operate the trust for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan.[7] In other words, the fiduciary has a duty under the Employee Retirement Income Security Act of 1974 to ensure that any expenses of operating the plan, to the extent they are paid with plan assets, are reasonable. We do not believe that bundled services in any way impede the plan sponsor's ability to carry out its fiduciary duties. On the contrary, as

[5] *Id.*

[6] Advisory Council on Employee Welfare and Pension Benefit Plans, ERISA Advisory Council, Report of the Working Group on Fee and Related Disclosures to Participants 5 (2004).

[7] ERISA section 404(a)(1).

long as the plan sponsor receives information that includes all of the services provided and the total costs, he or she should be able to compare this to information from other bundled providers as well as unbundled providers and determine whether the fees, taken in totality, are reasonable for the services being provided. As long as the plan sponsor is fully informed of the services being provided, it can compare and evaluate whether the overall fees are reasonable without having to analyze fees on an itemized basis.

GENERAL PRINCIPLES ON PLAN FEE DISCLOSURE

For this hearing, we were asked to specifically highlight the concerns of small business plan sponsors. Of course, the issue of plan fee disclosure concerns Chamber members of all sizes; therefore, it is important to share the Chamber's general principles on plan fee disclosure. Over the past year, the Chamber has testified before the House of Representatives and submitted several sets of comments to the Employee Benefits Security Administration (EBSA).[8] The Chamber's comments reflected not only concerns about new rules on plan fee disclosures, but also formed the principles with which the Chamber views any forthcoming reforms to plan fee disclosures. These principles are outlined below.

The Importance of Plan Fees Should be Considered in the Appropriate Context. Over the past year, plan fees have received a lot of publicity. While highlighting the importance of fees in the investment context, this publicity has also possibly had the negative effect of implying that plan fees are the only factor to consider when making investment decisions. This could be detrimental to both participants and plan sponsors.

Participants making investment decisions should not rely solely on the fees associated with the investment option. While the fees are an important part of the consideration, there are several other factors that may be considered, such as historical performance and investment risk. In its testimony before Congress, the Government Accountability Office (GAO) also recognized the importance of a variety of factors when making investment decisions, even noting that "higher fees can also arise if an investment option has additional features."[9]

Similarly, plan sponsors may begin to feel that they need to choose the least expensive investment option in order to avoid litigation claims. However, the lowest fees are not a guarantee of the best performance. Moreover, plan sponsors may desire services or features that are not included in the lowest fees. Therefore, it is necessary for plan sponsors to also consider expenses in the greater context of investment performance and features.

Fee Disclosures to Participants Should be Useful and Easy to Understand. As you are aware, plan participants already receive many notices from the plan. While some participants may read and digest these notices, most participants bypass the information without receiving any benefit from it. For this reason, we believe that fee information provided to participants should be stated as clearly as possible. In addition, the Chamber recommends that this information be combined with other notices already required to be sent to the participant.

The Chamber also suggests that information on fees should be limited to the amounts that are paid by the participant. There is general agreement that analyzing plan fees between providers, plans, and participants is complicated. Each individual plan sponsor determines how much of the fees they will pay and how much participants will pay. As mentioned above, plan sponsors consider a number of factors in addition to expenses when choosing a service provider. If the plan sponsor chooses to pay those additional costs and it does not impact the participants' ac-

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[8] On September 8, 2008, the Chamber submitted comments to the Department of Labor on the proposed rule on Fiduciary Requirements for Disclosure in Participant-Directed Individual Account Plans. On March 31, 2008, the Chamber testified before the Department of Labor on the disclosure of fees between service providers and plan sponsors. On February 11, 2008, the Chamber submitted joint comments with the ERISA Industry Committee, the College and University Professional Association for Human Resources, the National Association of Manufacturers, the Profit Sharing/401(k) Council of America and the Society for Human Resource Management to the Department of Labor on the proposed regulations issued under ERISA section 408(b)(2). On October 30, 2007 Harold Jackson, President and CEO of Buffalo Supply, Inc. testified on behalf of the Chamber before the House Ways and Means Committee on the appropriateness of plan fees from the perspective of the small business plan sponsor. On October 4, 2007 the Chamber presented a joint witness in a hearing before the House Education and Labor Committee on the 401(k) Fair Disclosure for Retirement Security Act of 2007 (H.R. 3185). On July 24, 2007, the Chamber submitted comments to the DOL in response to their request for information on Fee and Expense Disclosures to Participant Account Plans.

[9] United States Government Accountability Office, Private Pensions: *Changes Needed to Provide 401(k) Plan Participants and the Department of Labor Better Information on Fees* 19 (2006).

counts, then this information is not relevant to the participants and may create unnecessary confusion.

Disclosure Requirements Should Not be Unduly Burdensome. Plan sponsors are subject to numerous statutory and regulatory requirements and must constantly balance costs against the benefits of maintaining the retirement plan. Consequently, it is important to minimize the burdens on plan sponsors. In its 2004 report, the ERISA Advisory Council noted this concern:

> The working group wants to avoid a rule that is so burdensome that it discourages the adoption and maintenance of defined contribution plans. Section 401(k) plans in particular have become popular and convenient investment vehicles for the U.S. workforce. Disclosure rules should not be so onerous that they impede this popular and useful savings vehicle.[10]

The Chamber very much agrees with this statement and urges this to be kept in mind as the process moves forward.

The Chamber does not have a specific proposal for the disclosure format, but has several general recommendations. We recommend that disclosure information be as efficient in length as possible to keep participants from being overwhelmed with information. If possible, we also recommend that fee information be included as part of other notice requirements to minimize the amount of notices that are being created and sent. For example, including fee information with the participant benefit statement or the summary annual report should be considered. Finally, we recommend that plan sponsors be given flexibility in the method of distribution of the notice (electronic, paper, intranet, etc.) and in design of the notice. Because plans and investment options vary significantly, it could be a tremendous burden on some plan sponsors to have to comply with rigid criteria.

Small Business Plan Sponsors May Require Additional Consideration. For all of the reasons mentioned above, we believe that it is critical to consider the additional burdens and obstacles that may be placed on small business plan sponsors when considering possible legislation.

CONCLUSION

As more workers become dependent on individual account plans for retirement, it becomes increasingly important to provide participants with information that will allow them to make well-informed decisions. Given the complicated nature of plan fees, it is not a simple task to discern which information and what format will prove most meaningful to participants—rather, it will take input and dialogue from many different parties and experts.

In particular, the concerns of small business plan sponsors need additional consideration. Unreasonable administrative requirements, additional liabilities, and potential costs increases could drive small businesses away from the private retirement system. At a time when small business retirement plans are beginning to experience success, we should encourage these efforts by creating requirements that fully consider the concerns and possible consequences to small business plan sponsors. We appreciate the opportunity to express our concerns and look forward to future conversations with you and other interested parties.

Senator HARKIN. Thank you very much, Mr. Hunt.

First, the issue has come up—I have listened carefully and read the testimony—the question about fiduciary responsibilities here. Starting with you, Ms. Lacy. There are fiduciary liability responsibilities in ERISA. Why are they important? It seems to me that better disclosure would make it easier for businesses to fulfill that fiduciary responsibility.

Ms. LACY. I entirely agree with you, Senator. We can argue whether or not the fiduciary duty should exist as it does, but the reality is it does. The small plan sponsor has the same obligation as the largest plan sponsor to meet that requirement that you act for the sole and exclusive benefit of your plan participants and the decisions that you make are prudent and reasonable. That duty exists.

[10] Advisory Council on Employee Welfare and Pension Benefit Plans, ERISA Advisory Council, Report of the Working Group on Fee and Related Disclosures to Participants 5 (2004).

So, it seems to me that the kinds of disclosures that are being proposed by the department and in legislation can only assist smaller plan sponsors in making sure that the information they are going to need has been provided to them. It puts the duty on the service providers to hand them the information.

As you well know, ERISA is more about process than if ultimately it turns out you made the right decision. No one is going to know what happens in the future with investments. So your requirement under the law is to be prudent about how you went about making your process. So the other advantage of these disclosures is they will create that kind of paper trail.

Senator HARKIN. Now you are not suggesting in any way that we look at removing this fiduciary responsibility, are you?

Ms. LACY. No, I am not. I am saying it exists, and let us help people meet it better.

Senator HARKIN. Now, Mr. Benna, you mentioned something I wrote down here. What was that term you used, oh, "fiduciary safe harbor." In other words, what I took from what you said was that maybe somehow we ought to look at removing this fiduciary responsibility for small businesses and providing some kind of a safe harbor. What does that mean?

Mr. BENNA. Well, the goal that you are talking about here is participants doing a better job of investing their money. And education, giving them all these choices and providing sufficient information for them to go out and make decisions on their own hasn't worked real well, and it is not going to.

Disclosure is necessary. I fully support the disclosure efforts you are talking about, but the framework I am talking about in terms of reducing employer liability is already there in the Pension Protection Act. You already passed it in Congress.

You included in PPA a thing called "qualified default investment option," which, when employers choose to utilize that provision as it was enacted in PPA and following the guidelines of the regulations of Department of Labor, they get fiduciary relief, greater fiduciary relief than they get under Section 404(c) of ERISA.

It is already there. I am just—the only thing I am suggesting that would be helpful to everybody in this field—participants, employers inclusive—is to make it clear that that protection that is there in PPA through the QDIA is applicable when a plan utilizes that structure for the operation of its entire plan rather than just default for participants who do not pick investments when they are enrolled.

I have used this provision. I mean, you want to talk about changing participant behavior. I have taken plans that operate the way we are talking here, and I have blown them up and I have moved all the participants into these type of funds where that is where their money is invested automatically. Then they have to choose if they want to go out and go back and run it the way they have been doing, by having to worry about knowing enough about all these different funds and their track records, etc.

So the framework is already there.

Senator HARKIN. Ms. Lacy, do you have any thoughts on that?

Ms. LACY. I believe the relief may be a bit more limited than Mr. Benna is describing. Although there are safe harbors if you default people into certain types of investments—lifecycle funds, managed accounts, balanced funds—a plan sponsor still has the fiduciary obligation to make a prudent selection of that fund, to monitor it and the costs and all of those things.

So the safe harbor in this kind of investment is all right, but you still have all your same obligations for putting people into them appropriately.

Mr. BENNA. May I come back on it? I agree with that. But one big burden that they do not have, which they now have under 404(c), is providing sufficient information for participants to make informed investment decisions, and that has proved to be unworkable. I mean, the reality of trying to turn 50 to 60 million amateurs into professional investors by providing enough information and education, you commented DOL's efforts on that model notice are admirable.

But, yes, I agree with you the average participant is going to look at it and say, "Hey, I want this." Why in the world wouldn't they take the fund with a 15 percent return? I mean, it is mission impossible continuing to play that game.

Senator HARKIN. Don't you think there could be decent software that could be developed?

Mr. BENNA. Well, it exists. It is there. But the problem is what has happened and the reason I concluded that it is not doing the job is that those who need help the most don't utilize it. The ones that tend to utilize it are the ones that are already interested and have investment savvy. They will go out and they will go access that and utilize it to fine-tuning what they are doing.

The bulk of participants who are clueless about what they are doing and how they are running won't take the time, don't have the interest, and still they have to apply it, and they may or may not apply it properly.

So, yes, it is a useful tool. Definitely the efforts to expand and make that available should be encouraged, but still it is not the ultimate answer.

Senator HARKIN. Thank you.

Mr. Hunt, I listened to you talk about the role of bundling. Nothing in our bill would prevent bundling. It just requires that you disclose the elements of the bundling.

Mr. HUNT. Right, and I think that is fine. But there is a danger in that some of the larger providers will use certain things as loss leaders to attract the retirement plan assets. They may show administrative costs at very small amounts and tack it on somewhere else. I just think there is a little danger in there.

Senator HARKIN. But if everything was lined up and we knew every exact fee that was being charged in the bundle, then both the sponsor would have a better idea and, hopefully, the participant, too.

Mr. HUNT. If we can do that—and there is also a danger in some of these companies that have proprietary funds. I think even just fee disclosure, there may still be some ways to have other fees in there that really are not going to be known to some degree. If it is a proprietary fund, there is trading issues. There is a lot that goes into a lot of this stuff.

Senator HARKIN. My time is running out.

Senator Enzi.

Senator ENZI. Thank you, Mr. Chairman.

I do want to thank all our witnesses on this second panel. It has been very educational, very diverse panel, representing a cross-section of consumers, small business, and financial expert opinions. I do have several technical questions that I will just give to you for a response rather than putting everybody to sleep in the audience. I have done that before.

Some of the accounting questions don't work very well, but I will address my first question to Mr. Benna and Mr. Hunt. While automatic enrollment under the Pension Protection Act has begun to get more workers saving in their retirement, we are still lagging on getting small businesses to offer retirement benefits. What should we be doing to facilitate small businesses to offer these 401(k) plans?

Mr. Benna.

Mr. BENNA. Well, first, they have to want to do it. Reality is that there are many small businesses that don't have an interest in offering a retirement plan for a variety of reasons.

You have to, in my opinion, segregate the small business—I hate to sound negative in terms of referring to "mom and pop" operation. But if we go out around the Capitol here and do a 10-, 20-minute tour, there are many small businesses that are mom and pop type operations that, for a variety of reasons, aren't likely to offer retirement plan, in my opinion and experience, pretty much regardless of what you do, other than if you picked up all the cost and somebody else paid for it for them.

That will continue to persist as a problem, in my opinion. I don't see it going away. I think there have been laudable efforts made with plans like the SIMPLE plan. It is unfortunate, in my opinion, that that program hasn't received more wide support than it has.

I know, Senator, in answering that question, one of the things—I get small business people who come to me frequently, and they will say, "I want to start a 401(k) plan." And the first question I ask them is, "Well, really? Are you sure? Let us talk about what is involved, and maybe a SIMPLE or a SEPP or other type of plan might be a better option for you rather than a 401(k)."

Continuing to get information out, as some of the government agencies have and others, showing that there are other programs out there for small business, and potentially, they should be getting more attention than what they are.

Coming back to this liability issue for small employers, that is a concern. If more effort were made to clarify the facts about the Pension Protection Act, such as, structuring your plan in a certain way for small business greatly reduces their liability exposure by going with that structure. I think that would help if the Department of Labor were to take the lead on that and clarify in their regulations that that has broader application than just for default investment opportunities.

Senator ENZI. Thank you.

Mr. Hunt.

Mr. HUNT. A couple of points. I think litigation is an issue, but that is not what we really hear is the issue from the small business owners that we work with. We work with a number of small business owners on their personal side, and oftentimes, we will recommend that they have a retirement plan.

I will give you an example. We have a small business owner that owns a countertop company, has 10 employees. He could put a large chunk of money away for himself and his employees. Tax laws would benefit him. His comment to us was, "My guys would rather have an extra 20 bucks a week in their paycheck." And that is the mentality that a lot of these small businesses are dealing with.

Education, I am not sure—for that type of business, I am not sure that education is going to be the factor. For the professional businesses, absolutely.

I think the other big issue is cost in the 401(k) world. I can't quote exactly what the numbers are, but I think the large company may run $20 to $30 or $40 per participant, mid-sized company $50 to $60 per participant, and a small business, the average individual—the fee per individual in that plan runs over $400. I know in my own business, we have 7 employees, and my estimated administrative cost for this year are $3,800. We pay all that for our employees. But that is a big chunk of money for a lot of small businesses, and that deters them from the 401(k) world.

As Mr. Benna said, the option of a SIMPLE IRA may be a better option. But in that situation, now people want to maximize their retirement plan benefits, they can't put away as much as they could in a 401(k). So there is a lot of issues here that—and a lot of it is education.

Like the comment you had on financial literacy because we have actually launched something called the Millennium Financial Literacy Series to be able to provide that type of education, a lifecycle type education, because everybody in a company is at a different stage in their lifecycle, and where does it fit in for you?

We are trying to take that by the horns and develop those types of programs for clients. I think that, as time goes on, more businesses in my business world will begin to do those types of things, too.

That is where I think maybe the fee transparency is a help because it is going to make people in my business need to be more competitive. From our standpoint, education and financial literacy is one of the things that helps us become more competitive.

Senator ENZI. Thank you.

Ms. Lacy, I want to thank you for your comment about the chart needing to have something about risk factor. That should be really predominant on our minds these last few weeks. There are some investments that have high returns, but it is because they are high risk.

On the fee structure, I am really conflicted about whether disclosing every single fee and cost would be beneficial, especially when we can't get individuals to read their disclosure statements, and those are fairly complicated.

In addition, if we force the disclosure of every single fee and cost, I assume that someone is going to have to pay for it, and that most likely will be the employee either through higher fees or through reduced services. Shouldn't there be a balancing of competing interests?

Ms. LACY. Senator, I absolutely agree with you that there has to be a balancing of the need for more information and costs that may result from that. And I can tell you there is no group that is more interested in keeping fees low for participants than the Pension Rights Center.

You have to effect that balance, and I think there are important differences in the level of information that participants need versus plan sponsors. I like the department's approach in saying you try and come up with something pretty simple that is disclosed to everyone, and then you allow people access through the Web, or however they get their information, to more details to the extent that they want to—there are individuals who do want to get down in the weeds. So you make sure the information is available for them.

At the plan sponsor level, there is definitely a need for a higher level of disclosure, not down to every fee or every cost certainly, but enough of the information that allows them to make prudent choices. I mentioned earlier that when you have an all-in fee, you can miss conflicts of interest in that that might be revealed with more information.

Particularly important, even if you said that with one fee you could make a prudent choice initially, my concern is there is a problem with monitoring over time. And by that, I mean let us say that a small plan sponsor looked at a number of different funds and made a choice that was an all-in fee of 50 basis points and 2 or 3 years down the line looked again and said, "I am still paying 50 basis points. That seems pretty reasonable to me after a few years."

Well, in reality, what has happened is participants are putting in more money, even if you don't have more participants, and that is compounding, we hope, in markets other than this one. And those assets are growing.

So that same 50 basis points is producing a lot more revenue, but a lot of the services, particularly administrative services, may not have changed much at all. Still doing the same reports, all the things that were done before. So you may have created over time opportunities for profits that didn't exist at the onset.

Senator ENZI. Thank you.

I have run out of time. So I won't——

Senator HARKIN. Ask that last question. I am going to——

Senator ENZI. Well, I was going to get Mr. Benna and Mr. Hunt's opinion on that as well——

Senator HARKIN. Go ahead and ask.

Senator ENZI [continuing]. On being conflicted on disclosing every single fee.

Mr. Benna.

Mr. BENNA. I think the regs, as proposed by Department of Labor, are a good starting point, the level that they require disclosure. Clearly, there are a lot of other areas of fees and transactions that take place that would not be covered by that. But those become even more difficult and costly to uncover, and I am not sure what value would be added to that.

I think the proposed regs disclose the vast majority of fees and are much, much better, obviously, than where we are currently.

Senator ENZI. Thank you.

Mr. Hunt.

Mr. HUNT. I think the disclosure of fees is a very good thing. As I mentioned before, there may be some difficulty from some of the plan providers in actually knowing where these fees are, exactly what they are disclosing because, I mean, you are an accountant. You know numbers can be jiggled here and there, and my fear is that low-cost providers may get the upper hand when they may not actually be the best choices.

We are actually working in several markets right now where we are seeing that. I am not going to talk names or particulars on that. But we are seeing that, and I think it is going to give us a competitive edge to—I don't know if "expose" is the right word. But to be able to go in and evaluate things and be able to provide the plan fiduciaries with the right information that maybe they are not really getting all the information.

Senator ENZI. I want to thank all of you, and I will submit some questions, if you would be so kind just to answer them.

Thank you.

Senator HARKIN. Thank you very much, Senator Enzi, and I thank all of you for great testimony and for the written testimony, but also the verbal testimony.

I ask consent that the record be held open for submissions for 10 days from both AARP and ASPPA and for their statements to be included in the record. They have submitted testimony.

[The information referred to may be found in Additional Material.]

Senator HARKIN. Thank you very much. I look forward to your continued advice and input as we move ahead on this this fall and probably again in the next year.

Thank you all very, very much. I appreciate it.

The committee will stand adjourned, subject to call of the Chair.

[Additional material follows.]

ADDITIONAL MATERIAL

PREPARED STATEMENT OF THE AMERICAN BENEFITS COUNCIL

The American Benefits Council (the Council) welcomes the continued dialogue regarding disclosure of fees with respect to section 401(k) plans. The role of section 401(k) plans in providing retirement security has grown tremendously over the last 25 years and is continuing to grow. In that light, legislative and regulatory actions with respect to such plans similarly take on an increased importance. Applicable legislation and regulations should ensure that these plans function in such a way as to help participants achieve retirement security. The Council supports fee transparency as a critical means of assisting participants in this regard. In the same time, we all must bear in mind that unnecessary burdens and costs imposed on these plans will reduce participants' benefits, thus undermining the very purpose of the plans. In addition, our voluntary retirement plan system depends on the willingness of employers to maintain plans; excessive burdens on employers will undercut their commitment to a system that millions of Americans rely on for their retirement security.

The Council is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either sponsor directly or provide services to retirement and health plans that cover more than 100 million Americans.

The Defined Contribution Fee Disclosure Act of 2007 (S. 2473), as introduced by Senators Harkin and Kohl, reflects a constructive dialogue with a broad range of parties in the retirement plan community. We commend Senators Harkin and Kohl for their openness to such a dialogue and for including many provisions that would improve fee transparency without undue burdens. We do, however, have certain concerns with respect to the bill and look forward to further discussion on a number of issues, including the following:

• ***Coordination with Department of Labor fee initiatives.*** The Department of Labor is near completion of its plan fee disclosure initiative. One of the three regulations, focused on reporting to the government from the plan sponsor, has been completed and our members are working towards compliance. The second of three, focused on disclosure from the service provider to the plan sponsor, has been sent in final form from the Department of Labor and is currently at OMB for clearance. The Department of Labor publicly stated at this committee's hearing that it is their goal to have this published as a final regulation in the "next several months." The last of the expected regulations, participant fee disclosure, has been proposed and the Department of Labor has stated that it is their goal to have it published as final by year's end. In its deliberation regarding these regulations, the Department of Labor received over 92 comments from representatives of the employee benefits, participant, and service provider communities. We believe this regulatory approach will best balance input the Department of Labor received from various interested parties. We understand that Congress may review the regulations and conduct oversight of the implementation.

• ***Liability protections.*** In recent years, there has been significant growth in lawsuits with respect to defined contribution plans, giving rise to increased costs and the potential to stunt the continued growth of defined contribution plans. The bill creates additional potential liabilities even for companies diligently trying to comply with all applicable rules. It is important that safe harbors be added to the bill so that plan fiduciaries and service providers acting reasonably and in good faith are not subjected to such potential liabilities.

• ***Unbundling.*** Although the bill reflects great strides with respect to the "unbundling" issue, more work needs to be done. Where services are offered only on a bundled basis, disclosure of costs on an unbundled basis provides information with no commercial significance. The expenses incurred in generating such disclosures thus do not generate information that is commercially usable, which is unfortunate since participants ultimately bear those expenses.

Also, to the extent that bundled charges become, in fact, unbundled, many more charges will be applied on a per-participant basis, rather than based on account size. This would result in a dramatic shift of costs from higher income, high-account balance employees to lower income, low-account balance employees.

• ***Effective date.*** It is extremely important that plan fiduciaries and service providers have sufficient time to modify their data collection, administrative, and communication systems in order to comply with the new disclosure requirements. We commend Senators Harkin and Kohl in this regard; their bill provides that its provisions will not take effect until at least a year after the Department issues final regulations implementing the provisions. We have some thoughts as to how to make the Harkin/Kohl effective date rule work even better, but we deeply appreciate the Senators' recognition of the critical transition issue.

We look forward to working on these and other issues as the legislative process moves forward. We share a common goal with this committee and with Senators Harkin and Kohl: a vibrant and transparent defined contribution plan system that delivers meaningful retirement security at a fair price and without unnecessary costs and liabilities.

PREPARED STATEMENT OF THE AMERICAN COUNCIL OF LIFE INSURERS (ACLI)

The American Council of Life Insurers (ACLI) has been an active participant in the dialogue regarding disclosure of fees with respect to section 401(k) plans. The role of section 401(k) plans in providing retirement security has grown tremendously over the last 25 years and is continuing to grow. In that light, Federal actions with respect to such plans similarly take on an increased importance and should ensure that these plans function in such a way as to help participants achieve retirement security. The ACLI supports fee transparency as a critical means of assisting participants in this regard. At the same time, we all must bear in mind that unnecessary burdens and costs imposed on these plans will reduce participants' benefits, thus undermining the very purpose of the plans. In addition, our voluntary retirement plan system depends on the willingness of employers to maintain plans; excessive burdens on employers will undercut their commitment to a system that millions of Americans rely on for their retirement security.

The ACLI represents 373 member companies accounting for 93 percent of the life insurance industry's total assets in the United States. Life insurers are among the country's leaders in providing retirement security to American workers, providing a wide variety of group annuities and other products, both to achieve competitive returns while retirement savings are accumulating and to provide guaranteed income past retirement.

The ACLI would like to recognize Senators Harkin and Kohl for their interest in this issue by introducing S. 2473, The Defined Contribution Fee Disclosure Act of 2007. We would also like to recognize the efforts of the Department of Labor (Department) on its plan fee initiatives to increase transparency. The Department is near completion of its plan fee disclosure initiative. One of the three regulations focused on revisions to the Form 5500 report plan sponsors must file with the government. The Department's revisions include substantial changes to the plan fee reporting required on Schedule C. The changes to Schedule C are effective for the 2009 reporting year and will dramatically expand and modify the information that is required to be reported about plan service arrangements.

The second of three, focused on disclosure of service fees by service providers to the plan sponsors, has been sent in final form from the Department to the Office of Management and Budget for clearance. The proposed regulation sets forth new requirements for determining the reasonableness of compensation paid for services to employee benefit plans under ERISA. Failure to conform to the rules in the proposed regulation would result in a prohibited transaction. The Department publicly stated at this committee's hearing that it is their goal to have this published as a final regulation in the "next several months."

The last of the expected regulations address new requirements for the disclosure of plan investment and fee information to participants and beneficiaries of individual account plans subject to ERISA. Failure to conform to the rules in the proposed regulation would result in a breach of the fiduciary's duty to the participants and beneficiaries. This regulation has been proposed and the Department has stated that it is their goal to have it published as final by year's end. In its deliberation regarding these regulations, the Department received over 90 comment letters from representatives of the employee benefits, participant, and service provider communities. We understand that Congress may review the regulations and conduct oversight of the implementation.

We share a common goal with this committee: a vibrant and transparent defined contribution plan system that delivers meaningful retirement security at a fair price and without unnecessary costs and liabilities. We look forward to achieving greater transparency for participants and plan sponsors as our members work to comply with the final regulations.

PREPARED STATEMENT OF THE AMERICAN SOCIETY OF PENSION PROFESSIONALS & ACTUARIES (ASPPA) AND THE COUNCIL OF INDEPENDENT 401(K) RECORDKEEPERS (CIKR)

The American Society of Pension Professionals & Actuaries (ASPPA) and the Council of Independent 401(k) Recordkeepers appreciates the opportunity to submit our comments for the record to the U.S. Senate Committee on Health, Education, Labor, and Pensions (HELP) on the very important issue of 401(k) fee disclosure.

ASPPA is a national organization of more than 6,000 retirement plan professionals who provide consulting and administrative services for qualified retirement plans covering millions of American workers. ASPPA members are retirement professionals of all disciplines, including consultants, administrators, actuaries, accountants and attorneys. ASPPA's large and broad-based membership gives ASPPA unusual insight into current practical problems with ERISA and qualified retirement plans, with a particular focus on the issues faced by small to medium-sized employers. ASPPA's membership is diverse, but united by a common dedication to the private retirement plan system.

CIKR is a national organization of 401(k) plan service providers. CIKR members are unique in that they are primarily in the business of providing retirement plan services as compared to larger financial services companies that primarily are in the business of selling investments and investment products. As a consequence, the independent members of CIKR, many of whom are small businesses, make available to plan sponsors and participants a wide variety of investment alternatives from various financial services companies without bias or inherent conflicts of interest. By focusing their businesses on efficient retirement plan operations and innovative plan sponsor and participant services, CIKR members are a significant and important segment of the retirement plan service provider marketplace. Collectively, the members of CIKR provide services to approximately 70,000 plans covering three million participants holding in excess of $130 billion in assets.

BACKGROUND

ASPPA and CIKR strongly support the Senate HELP Committee's interest in examining issues relating to 401(k) fee disclosure and the impact of fees on a plan participant's ability to save adequately for retirement. We are encouraged by the introduction of legislation by Congress on this issue. In particular, on December 13, 2007, Senate Special Committee on Aging Chairman Herb Kohl (D–WI) and Tom Harkin (D–IA) introduced S. 2473, the "Defined Contribution Fee Disclosure Act of 2007," in addition to the two 401(k) fee disclosure bills previously introduced in the House of Representatives in 2007:

(1) H.R. 3185, the "Fair Disclosure for Retirement Savings Security Act," sponsored by House Education and Labor Chairman George Miller (D–MA) and passed out of the full committee on April 16, 2008; and

(2) H.R. 3765, the "Defined Contribution of Plan Fee Transparency Act," introduced on October 4, 2007 and sponsored by House Ways and Means Committee Subcommittee on Select Revenue Measures Chairman Richard Neal (D–MA) and cosponsored by Rep. John Larson (D–CT).

We support all three bills' even-handed application of new disclosure rules to all 401(k) plan service providers and encourage the Senate HELP Committee to take the same path towards uniform disclosure requirements. Further, we also encourage you to strike the right balance between disclosure information appropriate for plan sponsors versus plan participants. To demonstrate how both of these goals can be accomplished, we have attached to these comments two sample fee disclosure forms for your consideration—one for plan fiduciaries and another for plan participants. Each is tailored to provide plan fiduciaries and plan participants with the different sets of information on fees that are needed to make informed decisions.

As you know, the Department of Labor (DOL) currently has one final and two ongoing 401(k) fee disclosure projects: (1) A revised Form 5500, including a revised Schedule C, which is now finalized and effective beginning on January 1, 2009; (2) a proposed ERISA § 408(b)(2) regulation, which provides sweeping changes on what constitutes a reasonable contract or arrangement between service providers and plan fiduciaries; and (3) a proposed ERISA § 404(a) regulation setting forth a complex set of new participant fee disclosure requirements. The DOL has publicly announced that they plan to have both the 408(b)(2) regulation and the participant fee disclosure regulations finalized by the end of 2008, with effective dates projected for sometime in 2009.

ASPPA and CIKR submitted comprehensive comment letters to the DOL on both the 408(b)(2) and participant fee disclosure proposed regulations.[1] In both of these comment letters, we recommended an extension of the proposed effective date(s) because of the significant implementation and compliance issues/costs involved, made a number of significant recommendations to improve each of the disclosure regimes in order to ensure that understandable and meaningful disclosure is provided, and stressed the need for uniform disclosure requirements—among all types of service providers.

ASPPA and CIKR strongly support the premise that plans and plan participants should be provided all the information they need about fees and expenses in their 401(k) plans—in a form that is clear, uniform and useful—to make informed decisions about how to invest their retirement savings plan contributions. This information is critical to millions of Americans' ability to invest in a way that will maximize their retirement savings so that they can achieve adequate retirement income. We support your efforts to craft legislation that will accomplish this goal.

PLAN SPONSOR 401(K) FEE DISCLOSURE—NEED FOR UNIFORM REQUIREMENTS

The 401(k) plan industry delivers investments and services to plan sponsors and their participants using two primary business models—commonly known as "bundled" and "unbundled." Generally, bundled providers are large financial services companies whose primary business is selling investments. They "bundle" their proprietary investment products with affiliate-provided plan services into a package that is sold to plan sponsors. By contrast, "unbundled," or independent, providers are primarily in the business of offering retirement plan services. They will couple such services with a "universe" of unaffiliated, non-proprietary, investment alternatives. Generally, the costs of the bundled and unbundled arrangements are comparable or even slightly less in the unbundled arrangement. Under current business practices, bundled providers disclose the cost of the investments to the plan sponsor but do not break out the cost of the administrative services. Unbundled providers, however, disclose both, since the costs are paid to different providers (*i.e.*, administrative costs paid to the independent provider and investment management costs paid to the managers of the unaffiliated investment alternatives).

Bundled and unbundled providers have different business models, but for any plan sponsor choosing a plan, the selection process is exactly the same. The plan sponsor deals with just one vendor, and one model is just as simple as the other.

Plan sponsors must follow prudent practices and procedures when they are evaluating service providers and investment options. This prudent evaluation should include an "apples to apples" comparison of services provided and the costs associated with those services. The only way to determine whether a fee for a service is reasonable is to compare it to a competitor's fee for that service.

The retirement security of employees is completely dependent upon the business owner's choice of retirement plan service providers. If the fees are unnecessarily high, the workers' retirement income will be severely impacted. It is imperative that the business owner have the best information to make the best choice.

While the DOL's proposed ERISA § 408(b)(2) rules (relating to whether a contract or arrangement is reasonable between a service provider and plan fiduciary) *would* require enhanced disclosures for service providers to 401(k) plan fiduciaries, the proposed regulation would require only an aggregate disclosure of compensation and fees from bundled service providers, with narrow exceptions, and would not require a separate, uniform disclosure of the fees attributable to each part of the bundled service arrangement. While we appreciate the DOL's interest in addressing fee disclosure, we do not believe that any requirement that benefits a specific business model is in the best interests of plan sponsors and participants.

Without uniform disclosure, plan sponsors will have to choose between a single price business model and a fully disclosed business model that will not permit them to appropriately evaluate competing provider's services and fees. Knowing only the total cost will not allow plan sponsors to evaluate whether certain plan services are sensible and reasonably priced and whether certain service providers are being overpaid for the services they are rendering.

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[1] We note that House Education and Labor Committee Chairman George Miller (D–CA), Senate HELP Committee Chairman Kennedy (D–MA), Special Aging Committee Chairman Herb Kohl (D–WI), Senate HELP Committee Member Tom Harkin (D–IA) and House Education and Labor Subcommittee Chairman Rob Andrews (D–NJ) also submitted joint comment letters to the DOL on both the 408(b)(2) regulation and participant fee disclosure regulation. These comments expressed concerns about the DOL's approach to these disclosure initiatives and requested additional actions be taken to protect plan participant and beneficiaries.

In addition, if the breakdown of fees is not disclosed, plan sponsors will not be able to evaluate the reasonableness of fees as participant account balances grow. Take a $1 million plan serviced by a bundled provider that is only required to disclose a total fee of 125 basis points, or $12,500. If that plan grows to $2 million, the fee doubles to $25,000, although the level of plan services and the costs of providing such services have generally remained the same.

The bundled providers want to be exempt from adhering to uniform disclosure rules and regulations. Simply put, they want to be able to tell plan sponsors that they can offer retirement plan services for free while independents are required to disclose the fees for the same services. Of course there is no "free lunch," and there is no such thing as a free 401(k) plan. In reality, the costs of these "free" plan services are being shifted to participants through the investment management fees charged on the proprietary investment alternatives, in many cases without their knowledge.

The uniform disclosure of fees is the only way that plan sponsors can effectively evaluate the retirement plan they will offer to their workers. To show it can be done, attached is a sample of how a uniform, plan sponsor disclosure would look. By breaking down plan fees into only three simple categories—investment management, recordkeeping and administration, and selling costs and advisory fees—we believe plan sponsors will have the information they need to satisfy their ERISA duties.

PLAN PARTICIPANT 401(K) FEE DISCLOSURE—NEED FOR UNIFORM AND UNDERSTANDABLE REQUIREMENTS

The level of detail in the information needed by 401(k) plan participants differs considerably than from that needed by plan fiduciaries. Plan participants need clear and complete information on the investment choices available to them through their 401(k) plan, and other factors that will affect their account balance. In particular, participants who self-direct their 401(k) investments must be able to view and understand the investment performance and fee information charged directly to their 401(k) accounts in order to evaluate the investments offered by the plan and decide whether they want to engage in certain plan transactions.

The disclosure of investment fee information is particularly important because of the significant impact these fees have on the adequacy of the participant's retirement savings.

In this regard, studies have shown that costs related to the investments account for between roughly 87 percent and 99 percent of the total costs borne by participant accounts, depending on the number of participants and amount of assets in a plan.[2]

ASPPA and CIKR urge that any new disclosure requirements to plan participants also be uniform, regardless of whether the service provider is bundled or unbundled. On July 23, 2008, the DOL issued proposed regulations on participant fee disclosure that required the annual disclosure to plan participants and beneficiaries of identifying information, performance data, benchmarks and fee and expense information in a comparative chart format, plus additional information upon request. The proposed regulation further required an initial and annual explanation of fees and expenses for plan administrative services to plan participants and beneficiaries (disclosed on a percentage basis) *except* to the extent included in investment-related expenses.

The effect of this exception will be to highlight administrative costs for one business model (unbundled) over another (bundled), which would result in a disparity of treatment and confusion.

In most plans, the administrative costs of recordkeeping, reporting, disclosure and compliance are borne, at least to some extent, by the investments. For bundled providers, the entire administrative cost is generally covered by investment-related fees charged on proprietary investments. For an unbundled provider, however, those costs are often paid through revenue sharing received from unrelated investments, which, in many instances, is not sufficient to offset the entire cost. Accordingly, for unbundled providers, there would be a direct administrative charge assessed against participants' accounts.

In effect, the DOL's requirement to disclose administrative expenses *except* to the extent included in investment-related expenses would impose an additional and burdensome disclosure requirement on unbundled service providers, whereas there would be no such disclosure in the case of a bundled service provider. This would be misleading to most plan participants. In only the unbundled case would partici-

[2] 2007 edition of the *401 (k) Averages Book*, published by HR Investment Consultants.

pants see separate administrative costs charged against his or her account, while with bundled providers, participants would be given the impression there were no administrative costs at all as the administrative costs would be imbedded in the investment costs.

Accordingly, as the Senate HELP Committee considers any legislation in this area, ASPPA and CIKR recommend that the disclosure of administrative and investment information be provided on a uniform basis. We believe that administrative fee information provided on the same annualized basis as investment costs would provide participants a more complete picture of the total costs of the plan at a single time, regardless of the business model of a service provider.

It is important to recognize that there is a cost to any disclosure, and that cost is most often borne by the plan participants themselves. To incur costs of disclosure of information that will not be relevant to most participants will unnecessarily depress the participants' ability to accumulate retirement savings within their 401(k) plans. Thus, appropriate disclosure must be cost-effective, too. The result of mandatory disclosure should be the provision of all the information the plan participant needs, and no more. To require otherwise would unjustifiably, through increased costs, reduce participants' retirement savings. Those participants who want to delve further into the mechanics and mathematics of the fees associated with their investment choices and other potential account fees should have the absolute right to request additional information—it should be readily available on a Web site, or upon participant request. This will take care of those participants who feel they need more detailed information.

For the committee's consideration, ASPPA and CIKR have attached a sample fee menu to the testimony that we believe would contain, in a clear and simple format, all the information a plan participant would need to make informed decisions about his or her plan. It is consistent with the recommendations ASPPA and CIKR provided to the DOL on July 20, 2007 (in response to their request for information regarding fee and expense to disclosures in individual account plans) and on September 8, 2008 in a joint comment letter on the recent participant fee disclosure regulations.[3]

SUMMARY

The retirement system in our country is the best in the world, and competition has fostered innovations in investments and service delivery. However, important changes are still needed to ensure that the retirement system in America remains robust and effective into the future. By enabling competition, and supporting plan sponsors through uniform disclosure of fees and services, American workers will have a better chance at building retirement assets and living the American dream.

ASPPA and CIKR applaud the Senate HELP Committee's leadership in exploring issues related to 401(k) plan fee disclosure. The committee's consistent focus on retirement issues over the years has advanced improvements in the employer-sponsored pension system and led to an increased concern about the retirement security of our Nation's workers. ASPPA looks forward to working with Congress and the Administration on ensuring that both plan fiduciaries and participants receive complete and consistent 401(k) plan fee disclosures from all plan service providers.

[3] ASPPA and CIKR have also submitted the sample participant fee disclosure form to the House Education and Labor Committee (October 4, 2007), the Senate Special Committee on Aging (October 24, 2007) and the House Ways and Means Committee (November 1, 2007).

ABC Company 401(k) Plan

XYZ Service Provider Disclosure -- Expected Plan Expenses
For Plan Year Beginning January 1, 2008

The following expenses may be charged to to the plan. Some of these expenses may reduce the value of participant accounts. Some plan expenses may be paid by the plan sponsor.

I. Investment Expenses - The investments offered by the plan have related expenses. The amounts listed below are the annual percentage that will be charged based on the amount the participant placed in the particular investment.

EXAMPLE: If the fee is 0.50% and a participant placed $1,000 in that investment for one year, the participant's account would pay $5 for that type of expenses for that investment.

Investment Option	Investment Management Fees[1]	Administrative & Recordkeeping Fees[2]	Selling Costs & Advisory Fees[3]	Total
AAA Investment	0.50%	0.20%	0.25%	0.95%
BBB Investment	0.42%	0.20%	0.25%	0.87%
CCC Investment	0.20%	0.20%	0.25%	0.65%
DDD Investment	0.60%	0.20%	0.25%	1.05%
EEE Investment	0.35%	0.20%	0.25%	0.80%

II. Other Asset Based Fees - These fees are assessed on the total assets in the plan and are not investment specific.

Type of Fee	Investment Management Fees	Administrative & Recordkeeping Fees	Selling Costs & Advisory Fees	Total
Plan Level Fee		0.20%		0.20%
Investment Advisory Fees			0.40%	0.40%
- Plan Expense Reimbursement		-0.20%	-0.25%	-0.45%
Net Fees on Total Plan Assets		**0.00%**	**0.15%**	**0.15%**

III. Fees Paid Directly by Plan Sponsor - These fees are paid by the plan sponsor and are not paid out of plan assets.

Type of Fee	Investment Management Fees	Administrative & Recordkeeping Fees	Selling Costs & Advisory Fees	Total
Plan Sponsor Paid Fees		$1,000		$1,000

IV. Total Fees - These are the total fees based on estimated assets of $1 million and 20 participants. The fees assessed on investments are based on the allocation of investments by the 20 participants in the plan as of 90 days prior to the date of this notice. These amounts do not include transactional expenses (see below).

Type of Fee	Investment Management Fees	Administrative & Recordkeeping Fees	Selling Costs & Advisory Fees	Total
Total Expenses on Investments	$4,140	$2,000	$2,500	$8,640
Total Asset Based Fees			$1,500	$1,500
Total Fees Paid by Plan Sponsor		$1,000		$1,000
Total	**$4,140**	**$3,000**	**$4,000**	**$11,140**

V. Transactional Expenses - These fees are only charged when participants request the services described below.

Service	Fee
Brokerage Account	$60 per year
Participant Loan Origination Fee	$50 per loan
Distribution	$35 per distribution (including rollovers)

VI. Conflict Statement

All of the investments are provided by unaffiliated parties. XYZ Service Provider receives revenue sharing from all investments for recordkeeping and administrative services, and for advisory services, which is used to offset fees otherwise charged for such services as disclosed in Section II. above.

[1] Investment management fees are the portion of the expense ratio allocated to investment management expenses.
[2] Administrative and recordkeeping is the portion of the expense ratio attributable to administration and recordkeeping plus any additional administrative and recordkeeping charges attached to the investments.
[3] These include 12b-1 fees and other related selling costs and advisory fees attached to the investments.

ABC Company 401(k) Plan

Direct Participant Expenses
As of January 1, 2007

The following estimated expenses may be charged to your account, depending on the investments you select, the types of services received by the plan and the types of transactions you request. Fees are just one issue to consider when selecting an investment option, and you should consult other information provided by the plan sponsor regarding plan investment options before making a decision.

I. Investment Expenses - The investments offered by the plan have related expenses. The amounts listed below are the annual percentage that will be charged based on the amount you placed in the particular investment. A portion of the fee will be charged if you change your investments during the year. The expense ratio reflects the percentage of fund assets that are used for administrative, management, advertising and promotion (12b-1 fees), and all other expenses and directly affect the returns of your investment options. It does not include sales loads or brokerage commissions.

EXAMPLE: If the Expense Ratio is 0.5% and you placed $1,000 in that investment for one year, you would pay $5 for these types of expenses for that investment. Additional expenses, such as a wrap fee, redemption fee and/or surrender charge may also apply.

Investment Option	Expense Ratio (as a percentage)	Investment-Specific Wrap Fee	Redemption Fee[1]	Surrender Charge[2]
AAA Investment	0.30%	0.00%	0.00%	0.00%
BBB Investment	0.50%	0.10%	0.00%	6.00%
CCC Investment	0.40%	0.20%	2.00%	0.00%
DDD Investment	0.25%	0.00%	1.50%	0.00%
EEE Investment	0.35%	0.00%	0.00%	3.00%
FFF Investment	0.40%	0.10%	0.00%	4.00%
GGG Investment	0.50%	0.00%	1.00%	0.00%
HHH Investment	0.55%	0.25%	1.25%	0.00%

II. Fees on Total Plan Assets[3] - These fees are assessed on the total assets in your account and are not investment specific. Wrap fees are for various expenses, such as sales commissions, administrative expenses, and/or recordkeeping fees.

Type of Fee	Amount of Fee
Wrap Fee	0.35%
Registered Investment Advisory Fees	0.50%
- Estimated Plan Expense Reimbursement Offset	-0.30%
Net Fees on Plan Assets	0.55%

III. Administrative and Transactional Expenses - The Annual Administrative and Recordkeeping Charge is paid by all participants. However, the remaining fees (*i.e.*, transactional expenses) are only charged when you request the service.

Service	Amount of Fee
Annual Administrative and Recordkeeping Charge	$50 per year
Brokerage Account	$60 per year
Participant Loan Origination Fee	$50 per loan
Annual Loan Charge	$25 per year
Distribution	$35 per distribution (including rollovers)
Domestic Relations Orders	$100 per order

1 May be imposed by provider as a result of changing your investments multiple times in a given period. See the investment provider's redemption fee policy for additional information.

2 May be imposed if you sell or withdraw money from the investment within a given number of years after you invest. This fee may be reduced based on the length of time your money has been invested. You should consult your plan sponsor for more information before engaging in any transactions with respect to this investment.

[3] Wrap fees and investment advisory fees are charged at the plan level. Some plans use expense reimbursements, such as revenue sharing, to offset these costs.

FUND DEMOCRACY CONSUMER FEDERATION OF AMERICA,
SEPTEMBER 22, 2008.

Hon. EDWARD M. KENNEDY, *Chairman,*
Hon. MICHAEL B. ENZI, *Ranking Member,*
U.S. Senate,
Committee on Health, Education, Labor, and Pensions,
Washington, DC 20210.

Re: 401(k) Fee Disclosure

DEAR CHAIRMAN KENNEDY AND RANKING MEMBER ENZI: We are writing on behalf of Fund Democracy and the Consumer Federation of America to supplement the record of the committee's recent hearing, 401(k) Fee Disclosure: Helping Workers Save for Retirement. We have responded previously to the Department of Labor's request for comments on 401(k) fee disclosure (Professor Bullard also has testified on this issue before the Senate Aging Committee) and would like to share our views with the committee as well. We believe that significant fee disclosure reform for

401(k) plans can substantially reduce overall plan expenses for beneficiaries and strengthen the foundation of Americans' financial security in retirement.

A primary goal of 401(k) regulation should be to ensure that Americans experience as much of the performance of the markets as possible.[1] Excessive investment expenses present one of the most significant impediments to the achievement of this goal. Fees paid by 401(k) beneficiaries directly reduce their investment returns and, as a result, their financial security in retirement. Of course, excessive regulatory compliance costs can also reduce investment returns. For that reason, fee disclosure reforms should be designed so that they generate a net benefit to 401(k) participants. We believe that transparent, standardized fee disclosure can create substantial net benefits for 401(k) beneficiaries by raising fee awareness among beneficiaries and increasing competition among industry participants.

The most important principle for fashioning good fee disclosure is to ensure that it is designed, not with the self-directed, fee-sensitive investor in mind, but rather to increase awareness of fees and their impact on investment returns among those retirement plan beneficiaries who do not currently demonstrate fee-sensitivity. To be effective in reaching these beneficiaries with meaningful information, disclosures must provide them with the information they need, in a form they can understand, and at a time when it is useful to them in making and assessing their investment decisions. Current disclosure practice fails all these standards. With that in mind, we believe that 401(k) fee disclosure should satisfy the following standards:

- *Delivery Vehicles:* Require inclusion of a fee table (described on p. 57) in the plan summary for all investment options available through the plan and require fee disclosures in account statements for each investment option in which the beneficiary is invested.
- *Content:* Require disclosure of hypothetical fees paid on a $1,000 investment, total expense ratios for the investment, and average expense ratios for comparable investment vehicles, with separate disclosure of additional (non-expense-ratio) expenses as applicable.
- *Fee Table:* The plan summary fee table should show: expense ratios for the investment option, total plan expenses for each investment option; the dollar amount of expenses paid by a hypothetical $1,000 account; and comparative expense ratios (*see* Exhibit A).
- *Additional Expenses:* Require disclosure of expenses that are not included in the plan expense ratio immediately below the fee table in the plan summary (*see* Exhibit A).
- *Comparative Fee Information:* Require disclosure in the fee table of average industry expense ratios for: each investment option and the plan *in toto* (*see* Exhibit A).
- *Format:* The fee table and other disclosures should be designed in consultation with disclosure experts to ensure that they effectively convey the key information in a way that is both readable and readily understandable by typical beneficiaries.
- *Differential Compensation:* If differential compensation is allowed for those who advise retirement plan beneficiaries, which we recommend against, require separate disclosure of differential compensation paid to advisers prior to the retention of an adviser, at the time of each recommendation of an investment option in connection with which differential compensation is received, and annually as long as the relationship with the adviser continues.

As noted, we have previously provided the Department with general guidance regarding 401(k) and, earlier this month, comments on the Department's disclosure proposal. We have attached the latter comments to this letter at Exhibit B. In short, while we congratulate the Department on making significant progress toward an effective, efficient disclosure model, we believe that its proposal does not satisfy the foregoing principles in significant respects and can be greatly improved. We hope that any legislation similarly follows the foregoing disclosure principles.

BACKGROUND

The importance of 401(k) plan fees needs no detailed elaboration here. As noted by the GAO, 401(k) plan fees "can significantly decrease retirement savings over

[1] For convenience, we refer to "401(k) regulation," "401(k) participants," and "401(k) plans," although our comments generally apply to all types of participant-directed plans. In addition, we use mutual funds as examples of 401(k) investment options because they are the most common type of investment option used in 401(k) plans.

time."[2] For example, the GAO estimates that paying an additional 1 percentage point in fees will reduce an account's ending balance after 20 years by 17 percent.[3] Mutual fund fees have a substantial impact on total 401(k) plan fees because the bulk of 401(k) plan assets are invested in mutual funds. As noted by the SEC, "[t]he focus on fund fees is important because they can have a dramatic impact on an investor's return."[4] The GAO's and SEC's observations regarding fees apply equally to other 401(k) investment vehicles.

The Department recently estimated the amount by which inefficient disclosure inflates 401(k) fees. It found a wide dispersion in 401(k) fees that it attributes "to market inefficiencies"[5] and estimates—"conservatively"—that "plan participants on average pay fees that are higher than necessary by 11.3 basis points per year."[6] One form of market inefficiency is the confusing way in which 401(k) fees are currently disclosed. We strongly agree with the Department's expectation that its fee disclosure proposal will "result in the payment of lower fees for many participants. . . . as more fee transparency fosters more price competition in the market."[7] However, as noted above we believe that the Department needs to make several improvements to its current proposal in order to maximize fee reductions that can be realized through truly transparent, coherent disclosure.

The amount of fees charged by a 401(k) investment option within any particular investment category is arguably the strongest predictor of its investment performance. For example, researchers have demonstrated the inherent unpredictability of mutual fund returns, with funds generally being no more likely, from one quarter to the next, to repeat top-quartile performance and to fall into the second, third or fourth tier. To the extent that a small minority of fund managers outperform the markets over the long-term, there is no evidence that professionals, much less amateurs, can identify those managers a *priori*. Unlike past investment performance, fees are highly predictable and represent a certain reduction in fund's performance. Thus, within any given asset class, fees arguably constitute the most important factor in the evaluation of different 401(k) investment options.

FEE-INSENSITIVE INVESTORS

The purpose of fee disclosure is not to provide the minimum information necessary to enable diligent, fee-sensitive investors to evaluate the cost of investing in their 401(k) plan, but rather to draw the attention of all investors to the importance of fees. The purpose of 401(k) fee disclosure reform should be to provide beneficiaries who are not currently sufficiently sensitive to the effect of fees on the performance of their 401(k) accounts the information they need to raise their awareness of these important issues.[8]

Recent research conducted by CFA and assisted by Fund Democracy indicates that a large percentage of those who invest through workplace retirement plans are not sensitive to fees.[9] In a recent survey on mutual fund purchase practices, only 51 percent of those respondents who purchased most of their funds through a workplace retirement plan said they considered fees even somewhat important.[10] Furthermore, workplace purchasers were the least fee-sensitive of the three purchase

[2] *Private Pensions: Increased Reliance on 401(k) Plans Calls for Better Information on Fees*, Government Accountability Office at 10 (Mar. 6, 2007).

[3] *Id.*

[4] *Report of Mutual Fund Fees and Expenses*, SEC Division of Investment Management at Part IA (Dec. 2000).

[5] *Fiduciary Requirements for Disclosure in Participant-Directed Individual Account Plans*, Employee Benefits Security Administration, Department of Labor 73 F.R. 43013, 43020 (July 23, 2008) ("DoL proposal") (citing Investment Company Institute, The Economics of Providing 401(k) Plans: Services, Fees, and Expenses (2006)).

[6] *Id.*

[7] *Id.* (citing James J. Choi, David I. Laibson, and Brigitte C. Madrian, "Why Does the Law of One Price Fail? An Experiment on Index Mutual Funds," NBER Working Paper W12261 (May 2006) (finding "that presenting the participants with a comparison fee chart, and not just a prospectus, reduced the fees paid by 12 percent to 49 percent depending on the group studied")).

[8] Jonathan Clements, Wall St. J. at D1 (July 18, 2007) (citing Morningstar finding that 13 percent of stock fund assets are invested in fund charging more than 1.5 percent annually and 24 percent of bond fund assets are invested in funds charging more than 1 percent annually).

[9] *Mutual Fund Purchase Practices*, an analysis of survey results by Barbara Roper and Stephen Brobeck, Consumer Federation of America, June 2006.

[10] *Id.* Thirty percent said fees were a very important factor in their fund selection, while 21 percent indicated fees were somewhat important. In contrast, 70 percent indicated fund company reputation was at least somewhat important, while 68 percent rated past performance as at least somewhat important.

groups identified by the survey.[11] This likely reflects in part the fact that workplace purchasers typically make their fund selections from a fairly narrow menu of options. However, the relative lack of investing experience and financial sophistication among workplace purchasers almost certainly also play a role.[12]

This general lack of investing sophistication is compounded by the fact that the financial media, financial advertisements and the structure of disclosure requirements consistently overemphasize the importance of past performance and underemphasize the significance of fees. The financial media's focus on "The Best Funds for 2007" as determined by their short-term investment performance sends exactly the wrong message regarding the factors that investors should consider when evaluating investment options. Financial advertisements focus almost solely on past investment performance, which has little predictive power, to the exclusion of fees, the impact of which is significant, relatively certain and quantifiable. Fee disclosure presents fees almost exclusively as a percentage of assets, which structurally minimizes the true significance of fees in the overall picture of an investor's portfolio. The effects can be seen in the fact that 68 percent of workplace purchasers in the CFA survey indicated that a fund's past performance was at least somewhat important to their selection, with 38 percent indicating it was very important—a far higher percentage than considered fees to be even somewhat important.[13]

For this reason, we believe it is essential that fee disclosure be designed to counter the misleading message that investors generally receive regarding the relative importance of fees. To benefit fee-insensitive investors, fee disclosure must be based on a "push" principle that measures the efficacy of disclosure by its success in promoting competition and efficiency. To accomplish this, fee disclosure for 401(k) plans should be crafted not only to make fee information available, but also to affirmatively direct beneficiaries' attention to fees and to do so in a way that helps them understand those fees and the effect they have on investment returns. In short, fee disclosure should be designed to overcome investors' predilection for overemphasizing past investment performance and discounting fees when making investment decisions. Investors' insensitivity to fees represents a market failure for which fee disclosure (rather than price regulation) offers the most cost-effective solution.

DELIVERY VEHICLES

The delivery vehicles used for fee disclosure play a crucial role in determining whether those disclosures are effective in directing fee-insensitive investors to consider fees when making investment decisions. Yet one of the most significant shortcomings of fee disclosure has been the reliance on investor-unfriendly delivery vehicles. Fees for 401(k) plan administration (i.e., plan-level fees, as apart from fees charged by investment options) are required to be disclosed only in Form 5500, where the fees are disclosed as a dollar amount, in contrast with the presentation of fees as a percentage of assets for most investment options. The Form 5500 is not required to be provided to beneficiaries, but is delivered only upon request.

In the mutual fund context, fund expenses are described in the prospectus and the dollar amount of expenses for a hypothetical fund account are provided in the annual report. Employers generally provide plan participants with the prospectus or a document that contains the fee information in the prospectus,[14] but they do not provide the annual report or the hypothetical fee information, and neither fund documents or any documents provided by employers provide fee information about comparable investment options. Thus, basic fee information for each investment option are not provided in the same place as plan-level fees, no hypothetical or comparative fee information is provided at all, and no information is provided that is specific to a beneficiary's account. Investor-specific information is contained only in the quarterly statement. The latter document is generally the document that inves-

[11] *Id.* The other groups were direct purchasers and those who purchased most of their funds through a financial professional outside a retirement plan.

[12] *Id.* Just 12 percent rate themselves as very knowledgeable about mutual funds, while nearly a third (32 percent) rate themselves as knowing only a little. They also tend to be somewhat younger and less educated than other mutual fund purchasers, and to have held mutual fund investments for a shorter period of time, particularly when compared with those who purchased most of their funds directly from a fund company or through a discount broker or fund supermarket.

[13] *Id.*

[14] As discussed further below, although fund expense ratios are standardized, they sometimes are not comparable because expenses that appear in the fund expense ratio for some funds may be excluded from the fund expense ratio for others (*e.g.*, transfer agency expenses may appear either in the fund expense ratio or in plan-level expenses). Expense ratios for non-mutual-fund investment options generally are not even standardized.

tors read, whereas fund prospectuses and plan summaries are likely to be summarily discarded with little or no review.

Reliance on these delivery vehicles assumes that investors are proactive and fee sensitive. The prospectus and Form 5500 require 401(k) beneficiaries to request information, calculate their total fees, and seek out comparative data on their own to put their total fees in context. One witness before the Department's Advisory Group suggested that, by combining Form 5500 and prospectus fee disclosure, a 401(k) beneficiary "should be able to readily calculate the aggregate fees that reduce the value of his or her account."[15] The witness concluded that 401(k) fees are "currently disclosed to participants in sufficient detail to allow participants to evaluate the costs they pay against the services they receive."[16]

We disagree. Few investors, and certainly not fee-insensitive investors, will make the effort to "calculate" fees in the manner described above. As we have noted previously, they simply do not place sufficient emphasis on fees in the first place. In addition, according to the CFA survey, most workplace mutual fund purchasers are unlikely to make use of the written information sources available to them. Just over 4 in 10 (43 percent), for example, rated the prospectus as even somewhat influential on their investment purchases, with only 19 percent rating it as very influential.

To change the behavior of fee-sensitive beneficiaries, fees must be presented in a document beneficiaries are likely to read, they must be presented in a standardized format, and they must be presented in a manner that makes it easy for beneficiaries to understand how they compare to fees charged by comparable plans and investment options. In keeping with this approach, we urge the Department to use the delivery vehicle most likely to be read by beneficiaries—the account statement—for disclosure of fee and other important information. Investors are most interested in monitoring the value and performance of their account and, secondarily, confirming recent account activity. The account statement therefore provides the ideal vehicle through which to direct beneficiaries' attention to their 401(k) plans' fees.

Account statements, however, provide information after the investment selection has been made. To provide beneficiaries with pre-investment fee disclosures, we also urge the Department to require that such disclosures be provided in a short document that summarizes the plans' essential features. Such plan summaries should be required to be presented to all employees who are eligible to participate in the plan. Like the account statement disclosures described above, these disclosures should also provide information that enables beneficiaries to easily determine how those fees compare to fees for comparable plans and investment options.

Finally, we strongly recommend that the Department encourage the use of the Internet and electronic communications as one appropriate delivery vehicle for fee information. The Internet and electronic communications offer the opportunity both to enhance fee disclosure for beneficiaries and to reduce plan expenses. For increasing numbers of investors, the Internet and e-mail constitute their primary information source and communication tool. According to the CFA survey, for example, nearly all workplace investors (91 percent) have access to the Internet, and the vast majority (87 percent) expressed a willingness to use the Internet for at least some mutual fund purchase-related activities.

At a minimum, all fee disclosure requirements should be required to be made on or should be easily accessible from employer web pages. Where delivery is required, e-mail, including especially employer intranets, should be mandated as a delivery option investors can choose to use. In appropriate circumstances, such as when an employee has affirmatively decided to use either medium to obtain and receive information, Internet posting and delivery by e-mail should be deemed sufficient to satisfy legal delivery requirements.

FORM OF DISCLOSURE

Disclosure of 401(k) fees should be provided in two forms. As noted above, 401(k) fees should be disclosed on beneficiaries' account statements, in order to ensure that they take fees into account when evaluating their 401(k) plans, and in a plan summary document, to ensure that beneficiaries are made aware of fees when they make their initial investment selections.

Account Statement Disclosure. The 401(k) plan document that investors are most likely to review is their account statement, and the Department therefore should re-

[15] *Report of the Working Group on Fee and Related Disclosures to Participants*, Advisory Council on Employee Welfare and Pension Benefit Plans at n.4 (2004) (*Advisory Report*) (quoting testimony of John Kimpel, Sr. Vice President and Deputy General Counsel, Fidelity Investments). Actually, the fee dollar amounts in the Form 5500 would have to be converted to a percentage of assets and then added to the investment option's asset-based fees.

[16] *Id.*

quire that account statements include 401(k) fee disclosure. The GAO recommended, for example, that the SEC require mutual funds to disclose in shareholders' account statements the dollar amount of fees paid during the period covered.[17] The SEC decided instead to require the disclosure of the dollar amount of fees charged on a hypothetical account in the annual report.[18] Although there are reasonable arguments regarding the relative costs and benefits of disclosing fees paid on a hypothetical account and actual fees, we believe there is no reasonable argument that fee disclosure is materially improved by including this information in the annual report instead of the account statement. It is simply unrealistic to believe that fee-insensitive investors read the annual report, much less find and study fee information that might be disclosed there. We commend the Department for proposing to require the disclosure of fees in dollar amounts and that this disclosure appear in quarterly statements, but we believe that this disclosure will be misleading if it does not reflect the total cost of investing in the plan.

Ideally, 401(k) fee disclosure would require that the following information appear in account statements: the fees paid on a hypothetical $1,000 account as a dollar amount, fees paid as a percentage of assets, and comparative fees for comparable plans and investments. Although disclosure of actual fees paid by beneficiaries is more likely to be understood by beneficiaries than hypothetical fees, we recognize that, at this stage in the development of fee disclosure for different collective investment vehicles (mutual funds and guaranteed investment contracts), requiring disclosure of hypothetical expenses may be the best solution. However, we believe that any solution should move current practices toward a disclosure system under which investors are told the dollar amount of fees they actually have paid.

The disclosure of the dollar amount of fees is of particular value because beneficiaries are more accustomed to thinking about expenses in dollars rather than percentages. Fee-insensitive beneficiaries are more likely to take notice of disclosure that looks more like a common bill for services than a mathematical calculation. A limitation of both dollar amount and percentage fee disclosures is that they mean little or nothing without a comparative context in which to place them. We therefore recommend that account statements also include comparative expense information (as described below) for each investment option. This information will help put the dollar amount of expenses in context and provide a basis for beneficiaries to consider whether the fees that they are paying are worth the price.

Standardized Fee Disclosure. Fee disclosure for 401(k) plans should be provided in the plan summary document and standardized to facilitate comparisons across different investment options within the 401(k) plans and to expenses in other comparable plans. To some extent, standardization of investment option fees already exists. For example, mutual funds are required to use a standardized format for their expenses ratios and other expenses. However, other investment options use non-standardized fee disclosure, which prevents investors from comparing the true cost of different investment options. The goal of standardization is further frustrated by the fact that payments for services sometimes occur at the investment option level and sometimes at the plan level. For example, 401(k) plans that invest in a retail class of mutual fund shares often pay lower plan expenses, because the mutual fund rebates part of its fees to the plan administrator to cover those expenses. If the mutual fund's fees are compared to investment options that do not use such a rebate structure, the mutual fund's fees will appear higher. An accurate fee comparison can be made only when the plan's total fees are considered.

There are a number of potential solutions to the standardization challenge. One solution would be to impose fee disclosure requirements on non-mutual-fund investment options that are similar to those for mutual funds. Such standardization is clearly in the best interests of beneficiaries. However, a variety of agencies have primary responsibility for fee disclosure for non-mutual-fund collective investment vehicles, and it is appropriate that these agencies' rules govern disclosure of fees charged by these investment vehicles. Until these agencies' rules can be brought into alignment, this is probably not a realistic approach. We encourage the committee to develop a framework under which different agencies will work toward establishing standardized fee disclosure for 401(k) investment options.

Another potential solution would be to require the disclosure of 401(k) fees on a functional basis. For example, fees for transfer agency functions could be identified separately, which would permit comparisons of these fees across different plans regardless of whether the fees were collected by the plan administrator, or by a mu-

[17] *See Mutual Funds: Information on Trends in Fees and Their Related Disclosure*, Government Accountability Office (March 12, 2003).

[18] *See* Shareholder Reports and Quarterly Portfolio Disclosure of Registered Management Investment Companies, Investment Company Act Rel. No. 26372 (Feb. 27, 2004).

tual fund and then rebated to the plan administrator. We believe that, at this stage, such functional fee disclosure could be administratively burdensome and excessively costly, and would be unlikely to greatly benefit plan beneficiaries. Fees generally are not disclosed on a functional basis under existing legal rules for collective investment vehicles or for 401(k) plans, and the cost of designing and implementing new systems to provide functional disclosure might not be justified. In any case, it is not clear that functional fee disclosure as a general matter is a cost-effective disclosure approach, and it can be misleading.[19]

We believe that the best immediate solution to the problem of standardizing 401(k) fees is to present each fee component in the context the plan's total fees. Toward this end, we recommend that standardization of 401(k) fees be accomplished through the use of a fee table (including a fee example) and a list of additional expenses as described below.[20]

Fee Table. As illustrated in Exhibit A, the fee table would include three categories of data for each investment option. These are: the investment option expense ratio,[21] total plan fees (including both the investment fees and the plan-level fees) as a percentage of assets, and the dollar amount of fees on a hypothetical account. For each category, a comparative expense figure would also be included. This approach has the advantage of permitting easy comparison of different investment options when the investment options' expense ratios are comparable, such as for mutual funds, and when they are not. The total expense ratio figure would not only provide a total cost figure, it would also help address the problem of non-comparable investment fee information. Where easily comparable fee information of the type provided by mutual funds is not available,[22] it would indirectly indicate the relative cost of different investment options, because the plan-level expenses for each option generally could be assumed to be relatively constant. Assuming that plan-level expenses are comparable across different investment options, to the extent that the total expense ratio for different investment options differed, the difference generally would be attributable to the cost of the investment options.

Additional Expenses. By making expenses charged through asset-based fees more visible, this approach may create an incentive to shift costs to other forms. To minimize any such cost-shifting designed to avoid disclosure, the Department should require that additional disclosures be provided along with the fee table listing expenses that are not included in the expense ratio table but that may be incurred directly or indirectly by beneficiaries. These expenses would include, for example, purchase and redemption fees, minimum account charges, and non-asset-based sales charges. These expenses should be presented as a percentage of assets or a dollar amount, depending on the basis on which they are deducted, with explanations as appropriate.

One disadvantage of the foregoing approach is that it may not fully remove the incentive to shift expenses, in this case from the expense ratio to the additional expenses category. For example, a 401(k) provider could reduce the plan's expense ratio by replacing an asset-based transfer agency fee with a flat fee for each account. This strategy would have the effect of artificially reducing the expense ratio, on the assumption that investors would pay less attention to the concomitant increase in the expenses listed in the additional expenses table. The problem of ex-

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[19] For example, one of the problems with mutual fund 12b–1 fees, which purport to reflect the use of mutual fund assets for distribution services, is that investors in funds that do not charge 12b–1 may actually pay just as much for distribution services as investors in 12b-1 fee funds. It can be extremely difficult to define precisely the different types of services for purposes of functional disclosure of fees.

[20] The overall structure of this approach is similar to fee disclosure for mutual funds, which includes an expense ratio, a list of other expenses, and a dollar-amount fee illustration.

[21] The Department has specifically noted a significant failing of the mutual fund expense ratio in its omission of portfolio transaction costs, which can equal many multiples of a fund's other expenses. *See* DoL Proposal at n.13; *see also* Jason Karceski, Miles Livingston and Edward O'Neal, Portfolio Transaction Costs at U.S. Equity Mutual Funds (2004), *available at http://www.zeroalphagroup.com/news/Execution__CostsPaper__Nov__15__2004.pdf*. Although the SEC has requested comments on ways to address this omission, it has yet to take final action. *See* Request for Comments on Measures to Improve Disclosure of Mutual Fund Transaction Costs, Investment Company Act Rel. No. 26313 (Dec. 18, 2003). We hope that the Department, the SEC and other regulators will work together to ensure that the mutual fund expense ratio and the expense ratio of other investment options include all of the relative costs of investing.

[22] As noted *supra* note 14, although fund expense ratios are standardized, they sometimes are not comparable because expenses that appear in the fund expense ratio for some funds may be excluded from the fund expense ratio for others (*e.g.*, transfer agency expenses may appear either in the fund expense ratio or in plan-level expenses). This distinction is partly responsible for the recent flurry of excessive fee cases brought against employers in connection with their 401(k) plans.

penses being shifted out of the expense ratio could be addressed by requiring that beneficiaries' account statements disclose, either as a dollar amount or a percentage of assets, the expenses incurred during the period that were not included in the expense ratio. Where such expenses were deducted, the disclosure would be disclosed in three parts: the expense ratio, the additional expenses calculated as an expense ratio, and the sum of the two.

CONFLICTS OF INTEREST AND DIFFERENTIAL COMPENSATION

One of the most difficult challenges presented by fee disclosure is the need to apprise investors of the conflicts of interests that fees can create. Advisers to 401(k) beneficiaries are permitted, subject to their fiduciary duty to their clients, to receive compensation from sponsors of products that the adviser recommends ("distribution compensation"). In limited circumstances, distribution compensation can be higher for one product than another, which creates a conflict between the interests of the adviser and the 401(k) beneficiary, as the adviser has an economic incentive to recommend the product that pays him the greatest compensation, even if it is not the best product for the beneficiary. The cleanest and best way to deal with such conflicts, in our view, is to eliminate them, by prohibiting all differential compensation to advisers of 401(k) plan beneficiaries. Absent such a ban, fee disclosure for 401(k) plans should inform beneficiaries of the existence of any conflict of interest created by differential compensation so that they can evaluate the objectivity and quality of the advice provided. We note that the Department's proposal is most deficient in this respect because it includes no provisions that address the issue of differential compensation.

Distribution compensation generally is paid out of other fees that already will have been disclosed to beneficiaries. This means that disclosure of the amount of distribution compensation is not needed to inform investors about the total cost of investing (although it would tell them how their fees were allocated among different services). Rather, disclosure of the existence and extent of the conflict is needed to inform beneficiaries about advisers' financial incentives.[23]

Advisers should be required to disclose prominently the extent to which their compensation may vary based on the investment options selected by the beneficiary. In order to qualify as "prominent," the disclosure should be in a separate document, e-mail message or web page. The disclosure must be provided separately because otherwise it is likely to be confused with fee disclosure that is designed to highlight the costs of investing, rather than the economic incentives of the adviser.[24] The disclosure should focus on the amount of the adviser's differential compensation in order to permit the beneficiary to evaluate the objectivity of the adviser's recommendations.

Moreover, differential compensation disclosure should be provided before the beneficiary makes the decision to retain the adviser so that the beneficiary can evaluate the adviser's services before soliciting recommendations. After the beneficiary has retained the adviser and received the adviser's recommendations, the opportunity to evaluate the wisdom of retaining that adviser will have passed. In this respect, the Department should require that, in addition to disclosure made prior to the retention of the adviser, the adviser specifically disclose any differential compensation received in connection with the recommended investments at the time that the recommendation is made. Finally, the Department should require that periodic reminders be provided to beneficiaries as long as differential compensation payments continue.

Some may argue that disclosure of differential compensation is too costly and complex. Advisers who choose to create the conflict of interest that differential compensation disclosure would address should not be allowed, however, to avoid disclosure of differential compensation because of the complexity and disclosure costs they are responsible for creating. If, for example, a mutual fund charged dozens of different fees that depended on an investor's particular situation, the fund's sponsor should not be heard to complain that the cost of fee disclosure far exceeded its benefits. In short, the cost of fee disclosure should be viewed not as a reason to permit conflicts of interest to be concealed, but as a natural market constraint on inefficient

[23] *See Confirmation Requirements and Point of Sale Disclosure Requirements for Transactions in Certain Mutual Funds and Other Securities, and Other Confirmation Requirement Amendments, and Amendments to the Registration Form for Mutual Funds*, Investment Company Act Rel. No. 26341, at Part II (Jan. 29, 2004) (explaining conflicts of interest necessitating requirement for point-of-sale of distribution compensation disclosure). There is no indication that final action on this four-year-old proposal is imminent.

[24] *See* Investment Advisers Act Rule 206(4)–3 (requiring disclosure of solicitor's capacity and compensation in a separate document).

pricing practices. To the extent that investors reject complex fee structures, such as differential compensation arrangements, when they are fully disclosed, fee disclosure should be viewed as having operated successfully by promoting informed investor choice, competition and efficiency.[25]

COMPARATIVE FEE INFORMATION

As noted above, we believe it is critical that the disclosure of 401(k) fees be accompanied by comparative fee information. The disclosure of fees accomplishes little when it is presented in a vacuum, because few investors can readily assess whether the fees charged are high or low relative to the services provided or the fees charged by comparable investments. Mutual fund investment performance information is required to be compared to the performance of a comparable market index, because regulations recognize the importance of putting performance in context, but funds are not required to do the same for fees. Providing comparative fee information makes even more sense than providing comparative investment performance information, because past fees (unlike past performance) are strongly predictive of future fees. Furthermore, fee comparisons are more valid than performance comparisons, because fees of different 401(k) plans generally will be more comparable than investment performance across different investment options.

Putting fee information in context by providing comparative information is important for a number of reasons. First, comparative information would promote competition among investment option providers and place downward pressure on fees. Second, comparative information would enable beneficiaries to evaluate the costs and benefits of investing in the 401(k) plan relative to other taxable and tax-deferred investment options.[26] Third, fiduciaries' interests may conflict with beneficiaries' with respect to the negotiation of 401(k) fees, since fiduciaries may be able to lower the administrative costs paid by the employer by shifting them onto plan beneficiaries in the form of asset-based fees.

Investment Option Fees. Without the context of comparative fee disclosure, the disclosure of an investment option's expense ratio is of limited utility. This information conveys the fact that an investment option and the plan are not free, but virtually all beneficiaries already know this.[27] Standing alone, the fees provide little basis for evaluating whether they are reasonable in light of the services provided. The disclosure of comparative fee information would provide beneficiaries with a general sense of whether an investment option is more or less expensive than its peers and increase the likelihood that beneficiaries will think about whether above-average-cost options are worth the price. Also, providing average cost information for comparable investments should increase the likelihood that beneficiaries will make appropriate cost comparisons—comparing a bond fund's fees to average bond fund fees rather than to fees for an actively managed stock fund, for example—rather than simply comparing costs among various investment options with very different cost characteristics and choosing the cheapest option.

Providing comparative fee information to beneficiaries would promote competition among investment option providers for several reasons. First, providing this information should help incentivize employers, who are primarily responsible for the selection of investment options, to choose a plan with lower investment costs. Second, many 401(k) plans offer multiple investment options with overlapping asset or style categories. In this context, beneficiaries' investment decisions constitute a secondary marketplace (the plan itself) within which investment option providers compete for assets. This marketplace is recreated in every plan with multiple investment options, which has the effect of combining the market power of investment decisions by beneficiaries across many plans. Even if fiduciaries fail to populate plans with low-cost investment options, beneficiaries will tend to move assets to lower cost providers, if the comparative cost of different options is prominently disclosed. Such intra-plan dynamics will promote competition and place downward pressure on fees.

[25] Although the speciousness of arguments that fee disclosure is too costly due to its complexity is most applicable to differential compensation arrangements, it is not limited to such arrangements. The same analysis applies to all types of complex fee arrangements, such as the use of different types of account and activity charges that are in addition to a fund's expense ratio and plan expenses as disclosed in the Form 5500.

[26] In theory, comparative disclosure would enable employees to compare employers based on the relative qualities of their 401(k) plans. We believe that this potential benefit is secondary to the benefits of promoting competition among investment option providers and facilitating an informed comparison of 401(k) and non-401(k) investment options.

[27] Although fee information may disabuse some beneficiaries of the misimpression that their employer pays all of the costs of a 401(k) plan, we are not aware of any evidence that a material number of employees hold this view.

Plan Fees. Second, even when a plan does not offer overlapping investment options, and comparative fee information therefore does not facilitate the comparison of different options,[28] comparative fee information would enable beneficiaries to make informed comparisons between 401(k) and non-401(k) investment vehicles. The axiom that employees should "max out their 401(k)" before investing elsewhere is no longer always valid advice,[29] because employees will sometimes be able to experience superior long-term, after-tax investment returns in other contexts. The proliferation of tax-deferred investment vehicles, many of which are designed, like 401(k) plans, for retirement planning, has provided numerous investment alternatives that offer tax advantages that are comparable to those offered by 401(k) plans. The historically low level of capital gains taxes relative to income taxes means that capital gains in 401(k) plans are taxed at higher income rates when distributed than are capital gains in taxable accounts when they are distributed.[30] Tax-managed funds, index funds and exchange-traded funds employ strategies that minimize taxes, thereby substantially minimizing their tax disadvantage relative to 401(k) plans. Thus, non-401(k) tax-advantaged investment vehicles, lower capital gains rates, and tax-minimizing investment vehicles mean that an employee may sometimes be better off investing outside of a high-cost 401(k) plan. Fee disclosure for 401(k) plans should facilitate fee comparisons with non-401(k) investment vehicles.

Potential Conflicts of Interest. It is important that comparative fee information be placed in the hands of beneficiaries, as their interests may not be aligned with those of the fiduciaries who choose investment options for plans and negotiate administrative agreements. Beneficiaries may have a stronger economic incentive than fiduciaries to reduce fees, because it is often beneficiaries who pay them. In some cases, beneficiaries' and fiduciaries' interests can conflict. Fiduciaries may have an incentive to choose high-cost investment options as a means of shifting expenses from the employer to the beneficiaries. Plan fiduciaries therefore may be conflicted, because they have an incentive to reduce plan expenses (i.e., expenses incurred by their employer) in return for accepting higher investment option expenses. Plan fiduciaries also may wish to be perceived as having successfully negotiated a low-cost administrative contract, or may simply be unaware of the trade-off between higher cost investment options and lower cost administrative services. Although fiduciaries generally will be more financially sophisticated than the average beneficiary, this is not always the case. Ultimately, beneficiaries have stronger economic incentives to uncover such tradeoffs. It takes only a single, activist beneficiary, armed with the appropriate information, to bring these issues to the attention of plan fiduciaries.

Form of Comparative Fee Information. Comparative fee information should be provided in the fee table for each investment option. The comparative expense ratio row should show average expense ratios for the investment option, and for total expenses, including investment and plan-level expenses charged as a percentage of assets (see Exhibit A). These data should be presented in a manner that ensures that they are easily distinguishable from, and readily comparable to, the plan's actual expense ratios. The Department should consider whether additional comparative information should be provided, such as the amount of the difference between each average expense ratio and the actual expense ratio or a graphic illustration of each investment option's expenses relative to the average. In making such decisions, about both content and format, the Department should consult with disclosure experts to help design disclosures that maximize beneficiaries' ability to understand key fee information.

Employers should be permitted to use a variety of sources for comparative data, provided that the information is provided by an independent third party. It may be

[28] In this context, comparative fee information would allow beneficiaries to appreciate that, for example, an international stock fund charged higher fees than a domestic stock fund, but we believe that the comparison among different investment categories should be based on beneficiaries' overall investment objectives, not their relative expenses. Comparisons of fees for investment options with different investment objectives may mislead beneficiaries by confusing the primary basis on which comparisons across different options should be made, which is one of the shortcomings of the Department's current proposal. Comparisons between actively and passively managed investment options, however, would yield significant benefits, and the committee certainly should consider mandating such comparisons.

[29] In contrast, the related axiom that employees should always "max out their 401(k) match" (i.e., fully exploit matching employer contributions) still holds.

[30] To some extent, this taxable account advantage is reduced because capital gains taxes are paid on an ongoing basis, whereas income taxes on 401(k) capital gains are not paid until distributions from the account are made. We encourage the committee to consider legislation that has been proposed that would permit the deferral of taxation of capital gain distributions by mutual funds that are re-invested in the funds. The taxation of re-invested distributions penalizes investors who choose to diversify their investments through mutual funds.

necessary, however, to establish guidelines regarding what constitutes appropriate comparative data for different types of investment. Employers also should be permitted to use average plan-level expense ratios that reflect the size of the plan, subject to appropriate guidelines.

COST ISSUES

As to the issue of which parties should bear the cost of providing fee information, we believe that the allocation of disclosure costs generally should be left to the marketplace. Each of the three principal providers of information to 401(k) beneficiaries—employers, plan administrators and investment option sponsors—has sufficient negotiating power to ensure that markets work efficiently to find the optimal allocation of costs among the different parties. For example, we recommend that beneficiaries' quarterly statements include uniform dollar fee disclosure, which would require the calculation of the dollar amount of fees that would have been paid by a hypothetical $1,000 account. If the annual cost of producing that information were $1.00 for the investment option sponsor, $1.05 for the administrator, and $1.10 for the employer, then we would expect the cost ultimately to be allocated to the investment option sponsor as the lowest-cost provider. Formally "allocating" the cost to the administrator, for example, would simply result in the administrator's paying the investment option sponsor to provide the information at lower cost, with the only economic difference being the added cost of negotiating the transfer of this responsibility from the administrator to the investment option sponsor.

Thus, allocating costs by rule will not change the ultimate allocation of costs, but it can be expected to increase total costs to the extent that the rule does not choose the most efficient information provider. In a competitive 401(k) market, all costs ultimately will be borne by the lowest-cost provider, because structures that allocate costs to higher-cost providers will lose market share to more efficient, lower-cost competitors.

Another aspect of cost allocation is the allocation of costs across different employers. The greatest risk of implementing new fee disclosure requirements is that they will increase the cost of 401(k) plans for small employers to the point that they will choose not to offer the plan at all. We urge the committee to be sensitive to these relative cost burdens for small plans and to seek ways to minimize them, including by identifying disclosure and other requirements that could be modified or eliminated in order to reduce 401(k) expenses.

Finally, some have questioned the relative costs and benefits of fee disclosure reform. As discussed at page 3 *supra*, we agree with the Department that fee disclosure stands to generate billions of dollars in savings for investors. Although we recognize that the economic analysis of the benefits of fee disclosure reform lacks scientific precision, the Department's findings are consistent with the widely accepted economic principle that price transparency promotes competition and reduces expenses. There is substantial evidence that investors are not sufficiently price sensitive, and we believe that enhanced price transparency, price standardization and comparative information will provide a powerful stimulus toward lowering the overall cost of investing by increasing price sensitivity. The steady migration of mutual fund investors to lower-cost mutual funds is partly, if not substantially, attributable to the high level of fee transparency mandated by the securities laws. We believe that fee disclosure reform will generate substantial net economic benefits to 401(k) participants.

CONCLUSION

Investment expenses represent a significant drag on the performance of 401(k) accounts that can be substantially mitigated through well-designed fee disclosure requirements. Although it is possible for an enterprising beneficiary to determine the total cost of his or her 401(k) plan's investment options and to find comparative fee information to place those costs in context, it requires enormous effort that only a tiny number of beneficiaries are likely to make. Fee disclosure reform is premised on the failure of many beneficiaries to be sufficiently sensitive to the impact of fees on their investment returns. Fee disclosure should therefore be designed to proactively direct fee-insensitive beneficiaries' attention to fees in order to stimulate competitive market forces and thereby reduce beneficiaries' expenses. We strongly encourage the committee to embrace the opportunity that efficient, proactive 401(k) fee disclosure reform offers as a means to enhance the retirement security of tens of millions of Americans.

Sincerely,

MERCER BULLARD,
President and Founder,
Fund Democracy, Inc.

BARBARA ROPER,
Director of Investor Protection,
Consumer Federation of America.

EXHIBIT A

Fee Table

Investment Option	Fund Expenses [In percent]	Total Plan Expenses [In percent]	Illustrative Annual Fee Paid on $1,000 Balance
Stock Fund	0.80	1.00	$10.00
Industry Average	**0.70**	**0.88**	**$8.80**
Bond Fund	0.50	0.70	$7.00
Industry Average	**0.45**	**0.63**	**$6.30**
Balanced Fund	0.65	0.85	$8.50
Industry Average	**0.60**	**0.78**	**$7.80**

Additional Expenses: Small Account Fee—$2.50/quarter; Redemption Fee—1.00 percent.

EXHIBIT B

FUND DEMOCRACY CONSUMER FEDERATION OF AMERICA,
SEPTEMBER 8, 2008.

Office of Regulations and Interpretations,
Employee Benefits Security Administration,
Room N–5655,
Department of Labor,
200 Constitution Avenue,
Washington, DC 20210.

Re: Participant Fee Disclosure Project

DEAR MS. HALLIDAY: We are writing on behalf of Fund Democracy and the Consumer Federation of America in response to the Department's request for comments on its proposed regulation on the disclosure of fee and other information for beneficiaries of participant-directed individual account plans ("401(k) plan participants"). Like the Department, we believe that fee disclosure reform for 401(k) plans can substantially reduce overall plan expenses for beneficiaries and strengthen the foundation of Americans' financial security in retirement.

In an earlier comment letter, we set forth the principles that should guide the disclosure of 401(k) fees,[31] and the Department's proposal substantially reflects key elements of those principles. For example, the Department proposes to require that all fees appear in a standardized, tabular format, which will be a significant improvement over fee disclosure for non-standardized investment options and the disclosure of plan expenses. The Department also proposes to require the disclosure of certain fees as a dollar amount and that this disclosure appear in participants' quarterly account statements. We applaud the Department for taking decisive steps to direct the attention of fee-insensitive participants to the impact of fees in a document that they are likely to read and in a way that is likely to draw their attention to the fees. As a whole, the proposal makes significant progress in increasing the transparency of 401(k) fees, promoting greater competition in the 401(k) marketplace, and, ultimately, helping to secure Americans' financial security in retirement.

In some respects, however, we believe that the Department's proposal can be improved. Our principal recommendations are as follows:

[31] *See* Letter from Mercer Bullard, Founder and President, Fund Democracy, and Barbara Roper, Director of Investor Protection, Consumer Federation of America to Office of Regulations and Interpretations, Employee Benefits Security Administration, Department of Labor (July 24, 2007) *available at http://www.funddemocracy.com/401k%20fee%20letter%20final.pdf*.

• *Total Fee Disclosure:* Investment option fees and administrative fees should be disclosed together in order that plan participants can evaluate the total cost of the 401(k) plan.

• *Revenue Sharing:* Fee disclosure should avoid misleading participants by suggesting false comparisons between investment option fees that include administrative fees (i.e., that compensate plan administrators through revenue sharing) and investment option fees that do not.

• *Comparative Fees:* Comparative fee information should be disclosed across comparable asset classes in order to promote competition among service providers.

• *Quarterly Statement Disclosure:* The disclosure in the quarterly statement of fees in dollar amounts should reflect total plan fees paid by the participant and clearly segregate fees that are specific to the participant.

• *Differential Compensation:* In order to fully apprise participants of the adviser's potential conflicts of interest, fee disclosure should include a prominent description of any compensation received by an adviser in connection with providing advisory services to a participant that may vary based on the participants' decisions with respect to the plan.

We look forward to working with the Department toward a final proposal that will provide the 401(k) plan participants with the kind of fee disclosure that will help them receive as much of the performance of the market as possible and thereby achieve financial security after their retirement.

BACKGROUND

As noted, we previously provided comments to the Department regarding 401(k) fee disclosure. Rather than re-state these comments, we incorporate them by reference in this letter. To summarize, we have listed below the key policies that we believe 401(k) fee disclosure should promote:

• *Fee Insensitive Participants:* Fee disclosure should target 401(k) participants who are less likely to be sensitive to the impact of fees on their investment returns by locating disclosure where fee insensitive participants are likely to review it and in a format that such participants are likely to understand.

• *Total Fee Disclosure:* Fee disclosure should clearly present the total cost of the plan in one place so as to facilitate comparisons and promote sensitivity to the true impact of fees on participants' investment returns.

• *Comparative Information:* Fee disclosure should promote competition by providing or at least facilitating comparisons across products and services both at the investment option and plan levels.

• *Differential Compensation:* If differential compensation is allowed for those who advise 401(k) participants, then fee disclosure should include specific information as to the amount of and trigger for such compensation paid to advisers: (1) at or before the initiation of the relationship with the adviser, (2) at the time of each recommendation of an investment option in connection with which differential compensation is received, and (3) annually as long as the relationship with the adviser continues.

Like the Department, we believe that fees can have a significant impact on a 401(k) participant's account balance at retirement and that improving fee disclosure can help reduce fees. We especially appreciate the Department's unequivocal position on the relationship between fee disclosure and excessive fees. The Department found a wide dispersion in 401(k) fees that it attributes "to market inefficiencies"[32] and estimates—"conservatively"—that "plan participants on average pay fees that are higher than necessary by 11.3 basis points per year."[33] One form of market inefficiency is the confusing way in which 401(k) fees are currently disclosed. We strongly agree with the Department's expectation that its fee disclosure proposal will "result in the payment of lower fees for many participants. . . . as more fee transparency fosters more price competition in the market."[34]

[32] Text accompanying note 11 (citing Investment Company Institute, The Economics of Providing 401(k) Plans: Services, Fees, and Expenses (2006)).

[33] Text accompanying note 13.

[34] Text accompanying notes 14–15 (citing James J. Choi, David I. Laibson, and Brigitte C. Madrian, "Why Does the Law of One Price Fail? An Experiment on Index Mutual Funds," NBER Working Paper W12261 (May 2006) (finding "that presenting the participants with a comparison fee chart, and not just a prospectus, reduced the fees paid by 12 percent to 49 percent depending on the group studied")).

FEE TABLE

The clearest example of how fee disclosure creates market inefficiencies is the current practice of providing investment option fees and plan fees in separate locations, and providing plan fees in a format that is difficult to understand or use for comparison purposes. Plan fees currently are required to be disclosed only in Form 5500 as a dollar amount on a plan-wide basis. Mutual fund fees (when they are the investment option) are disclosed in a fee table in the prospectus as a percentage of assets. Providing fee disclosure in the prospectus and Form 5500 makes it impracticable for participants to determine the total cost of their 401(k) plans. They cannot even compare fees of investment options because there is no standardized set of rules that applies across all types of investment options. Further, fees for certain services are included in investment option fees in some cases and in plan fees in others.

The Department's proposal to require disclosure of standardized fees for all investment options in a single fee table represents significant progress toward fee disclosure that will promote competition and reduce fees paid by 401(k) participants. The proposal will enable participants to compare the costs of different investment options and make a more informed investment decision. This will, in turn, promote competition among investment option providers and reduce fees. For example, participants will be able to compare easily the cost of an actively managed U.S. stock fund with the cost of a passively managed U.S. stock fund (if offered) and thereby make an informed decision as to which form of management provides a better value. Similarly, the proposed disclosure for plan fees will constitute a significant improvement over the Form 5500.

We are concerned, however, that the fee disclosure will be deficient—and even misleading—in important respects. One drawback of the proposal is that the investment option fees and plan fees would continue to be presented separately. We appreciate that it is important to encourage participants to compare the cost of different investment options within a 401(k) plan, but the separate presentation of investment option fees and plan fees effectively discourages the comparison of 401(k) fees with fees charged by other types of investment accounts. We recognize that, at one time, it would have been rare for an investor to be better off investing outside of their 401(k) plan, but changes in tax laws, the proliferation of tax-deferred investment vehicles, and the availability of low-cost mutual funds have created an environment in which many participants may be better off foregoing a high-cost 401(k) plan (although probably never to the extent of an employer matching contribution, if offered).[35]

We believe that the Department should design fee disclosure that facilitates not only comparisons within the plan, but also comparisons with investment options outside of the plan. Fee disclosure for 401(k) plans should show all of the costs of the plan in a single table that provides a total expense ratio for each option, including administrative expenses. Presenting the investment option fees and administrative fee separately will make it unlikely if not impracticable for participants to evaluate the total cost of the plan and compare it with non-plan investment options.

Another drawback of the proposal is that it encourages comparisons among investment options that are not truly comparable. The Department's Model Comparative Chart shows the fees for a Large Cap, International Stock and Mid Cap ETF option stacked one above the other in a single column. This is a false and potentially harmful comparison. Historically, large cap funds have been less expensive to operate than mid cap funds, which have been less expensive to operate than international funds. The Chart creates the impression that the international fund is more expensive relative to the others and this factor should count as a strike against it,[36] even if the international fund's fees were lower than the average for an international fund and the fees for the other two funds were above average relative to their peers. Thus, the investor might be inclined to choose the most expensive funds (relative to their class) while also failing to gain the benefit of diversification that investing in all three asset classes would provide. Most financial planners recommend that clients diversify their investments among different asset classes notwithstanding that this will mean paying higher fees for certain types of investments. The point

[35] *See* Testimony of Mercer Bullard before the Senate Special Committee on Aging at 7–8 (Oct. 24, 2007) (chart showing larger balance after 20 years in taxable account than in 401(k) account) *available at http://www.funddemocracy.com/Senate%20Aging%20Testimony%2010.24.07.pdf*.

[36] The actual Chart does not do this because the illustrative fee amounts are unrepresentative. The Large Cap fee is 2.45 percent and the International fee is 0.79 percent. The Mid Cap fee is only 0.20 percent, probably because it is actually a passively managed fund (as of the date of the Department's proposal virtually all ETFs were passively managed).

of fee transparency is not to promote competition among different asset classes, but among providers of product offerings within a single asset class.

The appropriate fee comparison for the Large Cap fund would be fees charged by the average Large Cap fund or the average offered by 401(k) plans. This information would apprise participants of the cost of the Large Cap fund offered by the plan relative to its peers and promote competition among Large Cap funds and plan sponsors to provide lower cost alternatives. We recognize that there is no universally accepted standard for determining the appropriate average fee to use as the benchmark for a particular type of fund, but it should not be difficult to generate one. The fund management industry cannot credibly complain, as it has in the past, that an objective classification standard would be too difficult to implement or understand when it willingly identifies funds as belonging in particular asset classes and other categories for marketing purposes, a practice that certainly implies that funds have an objective basis for doing so. Third-party information providers such as Morningstar and Lipper also have provided comparative fee information on funds in the same asset classes that fund boards use to satisfy their fiduciary duty to ensure that fund fees are reasonable. The data are available; there is no excuse for not providing it to 401(k) participants.

As illustrated by our proposed fee table at Exhibit A to this letter, 401(k) fee disclosure should provide participants with direct comparisons to similar types of funds. The classifications for different types of funds exist. It only remains for the Department to require that plans use this information in a way that will shine a spotlight on investment options whose fees significantly exceed a reasonable average. It is frankly remarkable that regulators require that the performance of a benchmark investment be disclosed with the presentation of an investment option's investment performance, while not requiring the same type of disclosure for fees. Studies have consistently shown that past mutual fund investment performance has a weak (if any) relationship to future performance, whereas fees and their impact are, obviously, very predictable from year to year. Requiring disclosure of benchmark fees would actually provide participants with meaningful information with which to make investment decisions and, we believe, have a profound impact on competition. In contrast, the most appropriate accompaniment for 1-year investment performance data generally would not be the performance of a benchmark, but rather a statement that the information reveals nothing about the relative merits of the investment.

A third drawback of the proposal is that participants, particularly fee-insensitive participants, will be inclined to assume that the fees that they see in one location reflect the total fees they will incur. If they review the investment option fee disclosure, they will tend to assume that those fees represent the total cost of the plan, and vice versa for those who review the administrative fee disclosure. This is not such an unreasonable assumption, for it seems counterintuitive to provide the fees for a single 401(k) plan in two parts in two separate locations. The Department has noted that the "lack of transparent fee disclosure in this market suggests . . . that individuals may underestimate the impact that fees and expenses can have on their account balances."[37] The separate disclosure of investment option fees and administrative fees will often cause participants to underestimate the total cost of the plan. We believe that it is imperative that the total fees for a 401(k) plan be presented in a single location.

A final drawback of the proposal is that it does not account for the different ways in which fees are charged by different plans. Fees for certain services may be charged at either the investment option level or the plan level. Specifically, certain administrative fees such as those charged for recordkeeping, accounting and legal services can be collected by the plan's third party administrator ("TPA") or by the investment option. When the fee is collected by the investment option and the services are actually provided by the TPA, the investment option remits the fees to the TPA. This practice is commonly referred to as "revenue sharing." When the administrative fees are charged at the investment option level, they will appear in the investment option fee disclosure and make the investment option fees seem higher and the plan fees lower. When they are charged at the plan level, they will appear in the plan fee disclosure and make the plan level fees seem higher and the investment option fees lower.

This diversity of practice has the potential to create confusion among participants who compare the investment option fees to investment options in other 401(k) plans or to investments in other types of tax-deferred and taxable accounts. The Department's proposal does nothing to resolve that confusion. When the 401(k) plan investment option fees do not include administrative expenses that are paid to the TPA,

[37] Text accompanying note 11.

then the 401(k) plan investment option fee will be artificially suppressed and seem lower, in comparison, than it actually is because the disclosure of the 401(k) plan's administrative fees will be provided in a separate location. If all expenses were combined in one place, as illustrated in Exhibit A to this letter, the true total cost of the 401(k) plan option would be transparent and provide a meaningful comparison.

QUARTERLY STATEMENTS

We also agree with the Department's decision to require the disclosure of fees in dollars in the quarterly statement, as opposed to disclosure only as a percentage of assets and only in plan documents. The primary target of 401(k) fee disclosure should be participants who are less sensitive to the impact of fees on their 401(k) accounts. These fee-insensitive participants are less likely to review plan documents for the purpose of evaluating fees charged to their accounts, and they are less likely to appreciate the impact of fees expressed as a (small) percentage of assets. These participants are more likely to review their quarterly statements, and they are more likely to take note of fees expressed as a dollar amount, especially when presented in the context of the dollar value of the participant's account. To illustrate, a 2 percent fee might seem insignificant to a less savvy 401(k) participant, but the presentation of a quarterly fee of $500 on an account with a $100,000 balance is likely to increase the likelihood that the participant will consider whether their fees could be reduced by switching to another fund in the 401(k) plan or choosing a lower cost investment in a taxable account.

We are concerned, however, that the quarterly statement disclosure will be misleading because it will not show the participant's total fees. As discussed above, participants will be inclined to assume that the fees disclosed in their quarterly statement reflect all of the fees they paid for the quarter. In fact, unless the proposal is amended, the quarterly disclosure will not show the investment option fees and will further understate total fees when fees for administrative services provided by the TPA are charged at the investment option level. Quarterly statement fee disclosure should show the participant's total fees. As noted in our previous comment letter, this disclosure need not necessarily show the actual dollar amount paid by the participant (we recognize the potential expense of such disclosure), but rather could reflect a rough estimation based on the account's beginning, ending or average account size. The goal here is not the precision of the disclosure, but rather the dollar format and the prominent location. Even an estimate will provide more accurate information than the partial information proposed to be disclosed.

Another difficulty is that the fee disclosure in the quarterly statement will be inconsistent across different plans. As discussed above, certain administrative services can be charged at either the investment option level or the plan level. This means that the fees disclosed in the quarterly statement for one participant may include fees for these services, whereas the fees disclosed on his neighbor's quarterly statement might not and would appear (artificially) lower.

Further confusion may be created by the mixing of participant-specific expenses with plan administrative expenses. The Department proposes that the "amounts actually assessed" for individual expenses, such as expenses attendant to a qualified domestic relations order, a loan to a beneficiary or investment advisory services be disclosed, and permits such disclosure to be provided "in a quarterly benefit statement." We believe that it would be extremely confusing for the dollar amount of administrative (or total plan expenses, as discussed above) to be combined with the dollar amount of individual expenses as an aggregate number. Based on the wording of paragraphs (c)(2)(ii) and (c)(3)(ii) of rule 404a–5, we assume that the Department does not intend to permit such combining of these expenses and suggest that it clarify this position to avoid any doubt.

However, even if the dollar amounts for administrative (total) and individual expenses are presented separately, as the rule seems to require, we are concerned that participants might not appreciate the important differences between the two types of expenses. We recommend that the Department require that administrative (total) expenses be presented in the quarterly statement in a way that makes it clear that the former are plan expenses and that the latter are expenses incurred on account of individual services provided to the beneficiary.[38] We believe that similar explanatory disclosure should be provided where information about the individual expenses that might be assessed is disclosed at the time of the beneficiary's eligibility and annually thereafter pursuant to paragraph (c)(3)(i).

[38] We agree that it is not necessary or cost-effective to "have administrative charges broken out and listed on a service-by-service basis." *See* Part B.2.

CONFLICTS OF INTEREST AND DIFFERENTIAL COMPENSATION

One of the most difficult challenges presented by fee disclosure is the need to apprise investors of the conflicts of interests that fees can create. Advisers to 401(k) beneficiaries are permitted, subject to their fiduciary duty to their clients, to receive compensation from sponsors of products that the adviser recommends ("distribution compensation"). In limited circumstances, distribution compensation can be higher for one product than another, which creates a conflict between the interests of the adviser and the 401(k) beneficiary, as the adviser has an economic incentive to recommend the product that pays him or her the greatest compensation, even if it is not the best product for the beneficiary. The cleanest and best way to deal with such conflicts, in our view, is to eliminate them, by prohibiting all differential compensation to advisers of 401(k) plan beneficiaries. Absent such a ban, fee disclosure for 401(k) plans should inform beneficiaries of the existence of any conflict of interest created by differential compensation so that they can evaluate the objectivity of the advice provided.

Distribution compensation generally is paid out of other fees that already will have been disclosed to beneficiaries. This means that disclosure of the amount of distribution compensation is not needed to inform investors about the total cost of investing (although it would tell them how their fees were allocated among different services). Rather, disclosure of the existence and extent of the conflict is needed to inform beneficiaries about advisers' financial incentives.[39]

We recommend that the Department require that advisers prominently disclose the extent to which their compensation may vary based on the investment options selected by the beneficiary. In order to qualify as "prominent," the disclosure should be in separate document, e-mail message or web page. The disclosure must be provided separately because otherwise it is likely to be confused with fee disclosure that is designed to highlight the costs of investing, rather than the economic incentives of the adviser.[40] The disclosure should focus on the amount of the adviser's differential compensation in order to permit the beneficiary to evaluate the objectivity of the adviser's recommendations.

Moreover, differential compensation disclosure should be provided before the beneficiary makes the decision to retain the adviser so that the beneficiary can evaluate the adviser's services before soliciting recommendations. After the beneficiary has retained the adviser and received the adviser's recommendations, the opportunity to evaluate the wisdom of retaining that adviser will have passed. In this respect, the Department should require that, in addition to disclosure made prior to the retention of the adviser, the adviser specifically disclose any differential compensation received in connection with the recommended investments at the time that the recommendation is made. Finally, the Department should require that periodic reminders be provided to beneficiaries as long as differential compensation payments continue.

Some may argue that disclosure of differential compensation is too costly and complex. Advisers who choose to create the conflict of interest that differential compensation disclosure would address should not be allowed, however, to avoid disclosure of differential compensation because of the complexity and disclosure costs they are responsible for creating. If, for example, a mutual fund charged dozens of different fees that depended on an investor's particular situation, the fund's sponsor should not then be heard to complain that the cost of fee disclosure far exceeded its benefits. In short, the cost of fee disclosure should be viewed not as a reason to permit conflicts of interest to be concealed, but as a natural market constraint on inefficient pricing practices. To the extent that investors reject complex fee structures, such as differential compensation arrangements, when they are fully disclosed, fee disclosure should be viewed as having operated successfully by promoting informed investor choice, competition and efficiency.[41]

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[39] *See* Confirmation Requirements and Point of Sale Disclosure Requirements for Transactions in Certain Mutual Funds and Other Securities, and Other Confirmation Requirement Amendments, and Amendments to the Registration Form for Mutual Funds, Investment Company Act Rel. No. 26341, at Part II (Jan. 29, 2004) (explaining conflicts of interest necessitating requirement for point-of-sale of distribution compensation disclosure).

[40] *See* Investment Advisers Act Rule 206(4)–3 (requiring disclosure of solicitor's capacity and compensation in a separate document).

[41] Although the speciousness of arguments that fee disclosure is too costly due to its complexity is most applicable to differential compensation arrangements, it is not limited to such arrangements. The same analysis applies to all types of complex fee arrangements, such as the use of different types of account and activity charges that are in addition to a fund's expense ratio and plan expenses as disclosed in the Form 5500.

CONCLUSION

We applaud the Department for a forward-thinking, creative and decisive approach to the current rules for the disclosure of 401(k) fees. With the growth of defined contribution plans and the increasing importance of participants' individual decisionmaking role, it has never been more critical to Americans' retirement security that 401(k) fees be subject to the disinfecting light of full transparency and the benefits of unencumbered market competition. The Department's proposal takes a significant step toward truly transparent, complete disclosure of 401(k) fees in a way that in the long term will save Americans billions of dollars in excess fees. We hope that the Department will capitalize on this opportunity to increase transparency and promote fee competition by addressing the concerns that we have discussed in developing its final proposal. Thank you for your consideration of our comments.

Sincerely,

MERCER BULLARD,
President and Founder,
Fund Democracy, Inc.

BARBARA ROPER,
Director of Investor Protection,
Consumer Federation of America.

PREPARED STATEMENT OF THE INVESTMENT COMPANY INSTITUTE

The Investment Company Institute[1] welcomes the interest of Chairman Kennedy, Senator Harkin, Ranking Member Enzi and the committee in enhancing disclosure in 401(k) plans and appreciates the opportunity to provide its views in connection with the committee's September 17 hearing. The Institute has long supported effective disclosure to participants in individual account plans and the employers who sponsor those plans.[2] Mutual funds currently provide the most complete disclosure of any investment product available in 401(k) plans and the Institute has extensively studied what information is useful to and used by investors. We value the opportunity to offer constructive input as the committee explores these issues and oversees regulatory efforts at the Department of Labor (DOL).

The defined contribution system of 401(k) and similar plans has been a huge success. As of 2007, Americans saved $4.5 trillion in private defined contribution plans, and another $4.7 trillion in IRAs. (Estimates suggest about half of all IRA assets originate from 401(k) and other employer plans.) Around half of all of the assets in defined contribution plans and IRAs are invested in mutual funds.[3]

Collaborative research between the Employee Benefit Research Institute (EBRI) and the Institute demonstrates that participants generally make sensible choices in allocating their investments[4] and that a full career with 401(k) plans produces adequate replacement rates at retirement.[5] Institute research also suggests that plan participants and plan sponsors are cost conscious when selecting mutual funds for their 401(k) plans. On an asset-weighted basis (that is, taking into account where 401(k) participants concentrate their assets), the average asset-weighted expense ratio for 401(k) stock mutual fund investors was 0.74 percent, half of the simple average stock mutual fund expense ratio in 2006 (1.50 percent).[6]

The biggest challenge in ensuring adequate retirement security for all Americans lies in encouraging workers to contribute and encouraging employers to offer a workplace plan. Disclosure reform should seek to improve the 401(k) system without imposing burdens, costs and liabilities that deter employers from offering plans. For these reasons, we urge the committee to proceed carefully as it examines the 401(k) disclosure regime.

Initiatives to strengthen the 401(k) disclosure regime should focus on the decisions that plan sponsors and participants must make and the information they need to make those decisions. The purposes behind fee disclosure to plan sponsors and participants differ. Participants have only two decisions to make: whether to contribute to the plan (and at what level) and how to allocate their account among the investment options the plan sponsor has selected. Disclosure should help participants make those decisions. Voluminous and detailed information about plan fees could overwhelm the average participant and could result in some employees deciding not to participate in the plan or focusing on fees disproportionately to other important information, such as investment objective, historical performance, and risks. On the other hand, plan sponsors, as fiduciaries, must consider additional factors in hiring and supervising plan service providers and selecting plan investment options. Information to plan sponsors should be designed to meet their needs effectively.

While we welcome congressional oversight and improved transparency, at this point we do not see the need for congressional action in light of the comprehensive DOL regulatory initiatives that should close the disclosure gaps that exist under current law.

PRINCIPLES FOR REFORM

• **Disclosure to plan sponsors should provide information that allows them to fulfill their fiduciary responsibilities.**

ERISA requires that plan fiduciaries act prudently and solely in the interest of plans and participants. Plan assets can only be used for the exclusive purpose of providing benefits and defraying reasonable expenses of administering plans. ERISA's prohibited transaction rules require that a contract with a service provider be for necessary services and provide only reasonable compensation. The Institute has consistently supported efforts to ensure that plan sponsors have the information they need as fiduciaries to select and monitor service providers and review the reasonableness of plan fees.[7]

Plan sponsors should obtain information from service providers on the services that will be delivered, the fees that will be charged, and whether and to what extent the service provider receives compensation from other parties in connection with providing services to the plan. These payments from other parties, commonly called "revenue sharing," but which are really *cost sharing*, often are used in bundled and unbundled service arrangements to defray the expenses of plan administration.

We also recommend that a service provider that offers a number of services in a package be required to identify each of the services and total cost but not to break out separately the fee for each of the components of the package. If the service provider does not offer the services separately, requiring the provider to assign a price to the component services will produce artificial prices that are not meaningful. In today's competitive 401(k) market, bundled and unbundled providers compete effectively for plan business. This healthy competition has helped spur innovation in 401(k) products and services, such as new education and advice programs and target date funds. Forcing a 401(k) provider to quote separate prices for component services would constitute an inappropriate decision by policymakers to favor one business model over another. So long as plan fiduciaries can compare the total cost of recordkeeping and investments of a bundled provider with the total costs of recordkeeping and investments of an unbundled provider, they have the relevant information to discharge their fiduciary obligations.

The Institute supports requiring that a service provider disclose to plan sponsors information about compensation it receives from other parties in connection with providing services to the plan. This information will allow the plan sponsor to understand the total compensation a service provider receives under the arrangement. It also will bring to light any potential conflicts of interest associated with revenue sharing payments, for example, where a plan consultant receives compensation from a plan recordkeeper.

Allocations among affiliated service providers are not revenue sharing. When services are provided by affiliates of the service provider, a plan sponsor should understand all the services that will be provided and the aggregate compensation for those services. The service provider should not be required to disclose how payments are allocated within the organization. These allocations are not market transactions and any pricing of these transactions will be artificial, and, thus, of little value. Disclosure of allocations within a firm will not inform the plan sponsor of additional compensation retained by the firm and will not inform the plan sponsor of a potential conflict that is not already apparent given the affiliation of the entities.

The DOL has issued proposed comprehensive disclosure regulations to address the information plan fiduciaries need. The regulations will require plan recordkeepers and other service providers to give employers comprehensive information on the aggregate compensation they receive before a contract is entered into, and on an ongoing basis thereafter. This includes information on direct payments from 401(k) plans to recordkeepers and payments from third parties. The disclosures will have to include information on other potential conflicts of interest faced by the recordkeeper. The regulations would not favor a particular business model by requiring providers to quote component prices for services offered as a package. Although the Institute made suggestions to DOL to improve the effectiveness of the regulation, the Institute supports DOL's general proposed approach.[8]

• **Disclosure to plan participants should be simple and focused on key information.**

Participants should receive the following key pieces of information for each investment product offered under the plan:

- Types of securities held and investment objective of the product.
- Principal risks associated with investing in the product.
- Annual fees and expenses expressed in a ratio or fee table.
- Historical performance.
- Investment adviser that manages the product's investments.

Participants also need information about the plan fees that they pay, to the extent the fees are not included in the disclosed fees of the investment products. Finally, participants should be informed of any transaction fees imposed at the time of purchase (brokerage or insurance commissions, sales charges or front loads) or at the time of sale or redemption (redemption fees, deferred sales loads, surrender fees, market value adjustment charges).

This list is informed by research on what information investors actually consider before purchasing mutual fund shares.[9] The research also found that investors find a summary of information more helpful than a detailed document. This basic information should be provided on all investment options available under the plan, regardless of type.[10]

Fees and expenses are only one piece of necessary information. While the fees associated with a plan's investment options are an important factor participants should consider in making investment decisions, no participant should decide whether to contribute to a plan or allocate his or her account based solely on fees. In many plans the lowest fee option is a money market fund or other low-risk investment because these funds are the least costly to manage. It is not appropriate for most participants to invest solely in these relatively lower return options." [11]

ERISA disclosure rules should encourage and facilitate electronic delivery of investment information to participants. Plans should be allowed to provide online disclosure for every investment option for those employees who have reasonable access to the Internet.

DOL has also issued a proposed regulation to improve the investment information provided to plan participants. Under the regulation, employers will have to provide all participants in 401(k) plans with critical and comparable information on all the investment options available to them. DOL's proposal uses a layered approach to ensure each participant receives key information, with more detail available online and upon request for those participants who want it. The proposal imposes new disclosure requirements with respect to all investment options, not just mutual funds, which the Institute believes is essential to an effective disclosure structure.[12] The need for cost-effective, simple disclosure focusing on the key information participants need to make informed choices, and which facilitates comparisons among investments, enjoys broad support.[13]

DOL's proposal coordinates with the SEC's proposal to improve and streamline the information provided to mutual fund investors.[14] With half of defined contribution plan assets in mutual funds, the changes to the disclosure system for plan participants should be consistent with the summary prospectus that the SEC develops for mutual funds; otherwise, 401(k) investors will bear the costs of mutual funds operating under different disclosure regimes.

- **Congress should not mandate a 401(k) plan's investment line-up.**

One proposal that is pending in Congress (H.R. 3185) would require a 401(k) plan to offer an index fund meeting certain requirements. The Institute is concerned with mandating in Federal law that 401(k) plans offer a particular type of investment option. Congress should not substitute its judgment for investment experts and mandate investment choices properly reserved to plan sponsors as fiduciaries. It also should not endorse one type of investment strategy (indexing) over another (active management). This represents a significant departure from the basic fiduciary structure of ERISA and the Institute is concerned about the precedent this would set.

The mutual fund industry is committed to meaningful 401(k) disclosure, which is critical to ensuring secure retirements for the millions of Americans that use defined contribution plans. We thank the committee for the opportunity to submit this statement and look forward to continued dialogue with the committee and its staff.

REFERENCES

1. The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the inter-

ests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $12.14 trillion and serve almost 90 million shareholders.

2. Attached to the testimony is a Policy Statement on Retirement Plan Disclosure adopted by the Institute Board of Governors in January 2007 that reaffirms and chronicles the Institute's long record in support of better disclosure.

3. Brady and Holden, *The U.S. Retirement Market, 2007*, ICI Fundamentals, vol. 17, no. 3 (July 2008), available at *http://www.ici.org/pdf/fm–v17n3.pdf*.

4. For example, in 2006, participants in their 20s allocated 59.7 percent of their accounts to pooled equity investments and company stock, and only 18.4 percent to GICs and other fixed-income investments. Participants in their 60s allocated 35.6 percent to GICs and other fixed-income investments. See Holden, VanDerhei, Alonso, and Copeland, *401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2006*, ICI Perspective, vol. 13, no. 1, and EBRI Issue Brief, Investment Company Institute and Employee Benefit Research Institute, August 2007, available at *http://www.ici.org/pdf/per13–01.pdf*. The 2006 EBRI/ICI database contains 53,931 401(k) plans with $1.228 trillion in assets and 20.0 million participants.

5. See Holden and VanDerhei, *Can 401(k) Accumulations Generate Significant Income for Future Retirees?* and *The Influence of Automatic Enrollment, Catch-Up, and IRA Contributions on 401(k) Accumulations at Retirement*, ICI Perspective and EBRI Issue Brief, Investment Company Institute and Employee Benefit Research Institute, November 2002 and July 2005, respectively, available at *http://www.ici.org/pdf/per08–03.pdf* and *http://www.ici.org/pdf/per11–02.pdf*, respectively.

6. Holden and Hadley, *The Economics of Providing 401(k) Plans: Services, Fees, and Expenses, 2006*, ICI Fundamentals, vol. 16, no. 4 (September 2007), available at *http://www.ici.org/pdf/fm–v16n4.pdf*.

7. See Statement of the Investment Company Institute to ERISA Advisory Council Working Group on Fiduciary Responsibilities and Revenue Sharing Practices (September 20, 2007), available at *http://www.ici.org/statements/tmny/07_dol_disclose_tmny.html*; Statement of the Investment Company Institute to ERISA Advisory Council Working Groups on Disclosure (September 21, 2004), available at *http://www.ici.org/statements/tmny/04_dol_krentzman_tmny.html*.

8. A copy of the Institute's comment letter is available at *http://www.ici.org/statements/cmltr/08_dol_provider_com1.html*.

9. See Investment Company Institute, *Understanding Investor Preferences for Mutual Fund Information* (2006), available at *http://www.ici.org/pdf/rpt_06_inv_prefs_full.pdf*.

10. Disclosure of this information is appropriate for mutual funds, insurance separate accounts, bank collective trusts, and separately managed accounts. The same key pieces of information are relevant and should be disclosed for fixed-return products, where a bank or insurance company promises to pay a stated rate of return. In describing fees and expenses of these products, for example, the disclosure should explain that the cost of the product is built into the stated rate of return because the insurance company or bank covers its expenses and profit margin by any returns it generates on the participant's investment in excess of the fixed rate of return. In describing principal risks of these products, the summary should explain that the risks associated with the fixed rate of return include the risks of interest rate changes, the long-term risk of inflation, and the risks associated with the product provider's insolvency.

11. In 2006, the asset-weighted average total mutual fund expense ratio for money market funds held in 401(k) plans was 0.43 percent, compared with 0.56 percent for bond mutual funds and 0.74 percent for stock mutual funds. See Holden and Hadley, *supra* note 6. In plans offering investment in employer stock, the employer stock option fund may be the lowest fee option because essentially no active investment management is involved, but it also would not be appropriate for participants to invest solely in one security. This point is made in the Department of Labor's publication for participants, *Taking the Mystery Out of Retirement Planning*, page 11, available at *http://www.dol.gov/ebsa/publications/NRTOC.html*.

12. Attached is the Institute's comment letter to the Department of Labor regarding improvements to participant disclosure.

13. This broad support is reflected in the joint recommendation by 12 trade associations to the Department of Labor in response to DOL's request for information. See *http://www.ici.org/statements/cmltr/2007/07_dol_401k_joint_com.html*.

14. See Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies, 72 Fed. Reg. 67790 (Nov. 30, 2007). The SEC's efforts are consistent with efforts to streamline mutual fund disclosure globally; both Canada and the European Union have proposed to amend their relevant disclosure documents to focus on key information. See Joint Forum of Finan-

cial Market Regulators, Point of Sale Disclosure for Mutual Funds and Segregated Funds (Proposed Framework 81–406, June 2007) (Canada); Committee of European Securities Regulators, Consultation Paper on Content and Form of Key Investor Information Disclosures for UCITS (CESR/07–669, October 2007) (European Union).

ATTACHMENTS.—INSTITUTE POLICY STATEMENT ON RETIREMENT PLAN DISCLOSURE AND INSTITUTE COMMENT LETTER TO DOL ON PARTICIPANT FEE DISCLOSURE PROPOSAL

ICI POLICY STATEMENT—RETIREMENT PLAN DISCLOSURE

In 2005, there were 47 million active participants in 401(k) plans, with their retirement savings invested not only in mutual funds but also a wide range of other investment products. As 401(k) plans assume increasing importance for future retirees, plan sponsors must be able to make the right choices in setting up their plans and participants must have the information necessary to make informed investment decisions. To that end, the Institute urges that the Department of Labor clarify the requirements for disclosure of the fees and expenses associated with 401(k) plans to assist plan sponsors in making meaningful comparisons of products and service providers. Similarly, we support action by the Department of Labor to require straightforward descriptions of all the investment options available to participants in self-directed plans. To achieve these important goals:

- **The Department of Labor should require clear disclosure to employers that highlights the most pertinent information, including total plan costs.**

We believe required disclosure to employers should focus on the total fees paid by the plan to a service provider (in the form of a percentage or ratio) and how expenses are allocated between the sponsor and participants. Required disclosure also should address the various categories of expenses associated with a plan, including arrangements where a service provider receives some share of its revenue from a third party. Under ERISA, the obligation to provide this information should rest with those parties having a direct relationship with the employer.

In the late 1990s, the Institute, in cooperation with other private-sector organizations, created a Model 401(k) Plan Fee Disclosure Form, which is posted on the Department of Labor Web site. More recently, the Institute also helped develop a list of service- and fee-related items that plan sponsors should discuss with potential providers. These tools serve to identify what services will be provided for the fees charged, show all forms of expenses, and help employers make meaningful comparisons among the products and services offered to the plan. The tools also can be useful to the Department in crafting regulations and other guidance.

- **The Department of Labor should require that participants in all self-directed plans receive simple, straightforward explanations about each of the investment options available to them, including information on fees and expenses.**

In making investment elections under a plan, individuals should receive information on: investment objectives; principal risks; annual fees (expressed in a ratio or fee table); historical performance; and the investment adviser that manages the product's investments.

The Department should expand the current disclosure requirements to require plan administrators to provide participants with a concise summary of these five key pieces of information for *each* investment option. One effective way to deliver this information is through e-mail and other forms of electronic communication. Additional information, such as how fees and expenses are allocated among service providers, should be made available to participants (for example, posted on the Internet).

Such disclosure requirements would fill gaps in the information currently required to be provided to participants. The existing disclosure regime does not cover all plans in which participants make investment decisions for their accounts. For plans that are covered, participants must receive full information about mutual funds, in the form of the fund prospectus. For other products, important information—such as operating expenses and historical performance—is available only on request. We support revising current rules to require a summary document for *all* self-directed plans that provides, for *each* investment product, the type of information that investors value and use. This information will empower participants in self-directed plans to manage their accounts effectively.

The mutual fund industry is committed to meaningful disclosure. Over the past 30 years, the Institute has supported efforts to improve the quality of information provided to plans and participants and the way in which that information is presented. Meaningful disclosure is critical to ensuring secure retirements for millions of Americans.

APPENDIX.—ICI'S RECORD: 30 YEARS OF ADVOCATING BETTER DISCLOSURE

The Institute has long acted both in conjunction with other organizations and on its own to enhance the ability of employers to make appropriate choices for their plans. The Institute also has consistently called for effective disclosure to plan participants about investment options. This appendix describes the Institute's efforts over time to improve disclosure for both plan sponsors and participants.

DISCLOSURE TO PARTICIPANTS

For more than 30 years, the Institute has provided specific recommendations to the Department of Labor on the disclosure participants in self-directed plans should receive about investment options. Through letters and testimony before the Department and the ERISA Advisory Council, we recommended regulatory measures to ensure that participants and beneficiaries receive adequate information on which to base their investment decisions.

- In a 1976 letter to the Department, the Institute advocated that when an individual becomes a participant, he or she should receive complete, up-to-date information about plan investment options, and, thereafter, regular and current information as to his or her investments.
- In 1987, the Institute recommended that under then-proposed 404(c) regulations, participants should receive the kind of information included in a mutual fund prospectus or Statement of Additional Information for all investment options—not just investment options subject to Federal securities laws. We repeated this suggestion in 2001 to the Department and in testimony in 2004 and 2006 before the ERISA Advisory Council.
- In 1992, the Institute recommended that where a 404(c) plan has a limited number of investment alternatives, plan fiduciaries should be required to provide sufficient investment information about each option up front. We urged the Department to specify the investment information that would be deemed sufficient, including information on fees and expenses and investment objectives.
- In testimony before the Department in 1997, the Institute asked the Department to address gaps in the disclosure regime, especially disclosure of administrative fees charged to participant accounts and information on annual operating expenses, which, for non-mutual fund investment vehicles, are required to be provided only upon request.
- In 1999, the Institute urged the Department to expand the scope of its proposed rules on electronic delivery to cover a broader range of disclosures and recipients.
- In testimony before the ERISA Advisory Council in 2004 and 2006, the Institute called for participants to receive clear and concise summaries of each investment option, including the product's investment objective, principal risks, fee/expense ratio (in the form of a fee table), and information about the investment adviser. In 2006, we added historical performance to the list. In the 2006 testimony, we also urged that this disclosure regime should apply to all self-directed plans—not just 404(c) plans—and that the Department update and expand its electronic disclosure rule in light of the increasing role of the Internet.

DISCLOSURE TO PLAN SPONSORS

The Institute likewise has consistently advocated clear rules for disclosure to plan sponsors and has developed various tools for use by sponsors and service providers.

- In 1999, the Institute published a Uniform 401(k) Plan Fee Disclosure Form, developed jointly with the American Bankers Association (ABA) and American Council of Life Insurance (ACLI). The form, which the Department posted on its Web site, is designed to help employers identify and monitor 401(k) plan fees and expenses and compare the fees and services of different providers.
- In testimony before the ERISA Advisory Council in 2004, the Institute called for clear, meaningful, and effective disclosure to plan sponsors. We recommended that plan sponsors be required to obtain complete information about investment options before adding them to the plan menu and obtain information concerning arrangements where a service provider receives some share of its revenue from a third party. The Institute offered to organize a task force to assist the Department in developing a disclosure regime for these compensation arrangements.
- In 2005, the Institute published a Model Disclosure Schedule for Plan Sponsors that might be used to disclose information on receipt by service providers of revenue from unaffiliated parties in connection with services to a plan. The Institute began

discussions with other trade associations on developing an appropriate disclosure regime.

• In 2006, the Institute published a 401(k) plan fee and expense reference tool, developed jointly with the ACLI, ABA, Securities Industry Association, and American Benefits Council. The tool is a list of fee and expense data elements that plan sponsors and service providers may want to discuss when entering into service arrangements. We have asked the Department to post the tool on its Web site.

INVESTMENT COMPANY INSTITUTE,
WASHINGTON, DC 20005–2148,
September 8, 2008.

OFFICE OF REGULATIONS AND INTERPRETATIONS,
Employee Benefits Security Administration, Room N–5655,
U.S. Department of Labor,
200 Constitution Avenue, NW,
Washington, DC 20210.

Attn: Participant Fee Disclosure Project

LADIES AND GENTLEMEN: The Investment Company Institute, the national association of U.S. investment companies,[1] strongly supports the Department of Labor's participant fee disclosure proposal, which will require that participants and beneficiaries in all self-directed defined contribution plans receive basic and comparable information on all the investment options available to them, regardless of type.

Under the proposal, participants would receive, at enrollment and annually thereafter, basic information about the plan, including plan-level fees. They would receive a chart containing information about each investment option designated by the plan fiduciaries, including the type of investment, whether it is active or passive, the investment's 1-, 5-, and 10-year return (compared against a benchmark), and the fees associated with the investment alternative, with annual expenses expressed as a total expense ratio. Participants would be referred to a Web site for more information on each investment, including the investment strategies and risks, the identity of the investment issuer or provider, portfolio turnover, and the assets held in the portfolio. More detailed information, like a copy of a prospectus or similar document, would be available to participants upon request.

We applaud the Department for seeking input prior to issuing this proposal through its Request for Information. This process showed dividends. The proposal focuses on the key information of use to participants and provides for comparability and clarity. It provides key information on fees, balanced with layered web-based disclosure on other key information. Many features of the proposal help ensure that the disclosure is useful to participants, the requirements are clear to plan fiduciaries, who have the obligation to provide the disclosure, and that the disclosure regime is cost-effective for plans and service providers. We urge the Department to retain these features:

• ***Avoiding a focus solely on fees.*** The fees associated with a plan's investment options are an important factor participants should consider in making investment decisions, but no participant should decide whether to contribute to the plan or allocate his or her account based solely on fees. The Department should retain the balance struck in the proposal so that participants do not receive disclosure that places undue emphasis on fees.

• ***Disclosing investment expenses in a straightforward format through the expense ratio.*** The expense ratio is a simple and widely understood way to disclose annual operating costs of an investment fund that can be applied to a variety of pooled products. It has been time-tested in SEC rules for disclosing mutual fund operating costs. Use of the total expense ratio also ensures comparability across investment products.[2]

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[1] The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $12.14 trillion and serve almost 90 million shareholders.

[2] We agree that fixed return products do not charge expenses in the same way that pooled products do. While an expense ratio may not be appropriate for GICs, certificates of deposit, and similar products (although it is for pooled funds of bonds or GICs), we recommend that the chart include a disclosure alerting participants that the cost of the fixed return product is built

Continued

• ***Ensuring participants understand the costs for buying and selling the plan's designated investments prior to making a decision.*** The proposal contains a requirement to disclose shareholder-type fees, which should include fees imposed at the time of purchase (brokerage or insurance commissions, sales charges or front-end loads) or at the time of sale or redemption (redemption fees, deferred sales loads, surrender fees, market value adjustment charges). It is particularly important that participants, before making an investment decision, understand any fees for exiting the investment within a certain period of time.

• ***Applying disclosure across all products.*** This proposal would establish baseline disclosure of key information for all products, regardless of type. This would fill a gap in the current 404(c) regulation which requires that participants receive a prospectus for mutual funds and other products subject to the Securities Act of 1933, but does not require delivery of key information like annual operating expenses and historical return information for other investment products. Closing this gap is important as investment funds that are not subject to the 1933 Act are increasingly being marketed to plans and participants.[3] We recognize that current disclosure systems do not always require that this information be developed and made available to participants and that plans, recordkeepers, and product providers will need to develop processes to do so. But that is exactly the point of this proposal and why adoption is so necessary. We strongly urge the Department to retain this feature of the proposal.

• ***Allowing fees to be disclosed in the manner in which they are charged.*** The proposal allows fees to be disclosed in the manner in which they are charged, recognizing that different types of fees are charged differently. While operating expenses of pooled funds in the plan's menu are charged in basis points (percentage of assets), plan level fees typically involve per capita or per transaction costs.

• ***Coordinating participant disclosures with securities law disclosures.*** Throughout the proposal the Department coordinated the proposed requirements with similar disclosures registered investment companies provide investors. This has the benefit of using time-tested disclosure methodologies and avoids requiring mutual funds to recompute information or produce entirely new calculations beyond those currently required by the SEC. For example, the methodology for computing mutual fund expense ratios, performance data, and benchmark information will satisfy the rule.

• ***Harnessing the power of web-based disclosure.*** The Internet is a particularly effective and efficient means to deliver disclosure, because of its ability to offer layers of information. The proposal makes an important step in this direction by allowing use of a Web site to provide layered disclosure. Below we offer recommendations on how the Department should update its electronic disclosure rules for this proposal.

These principles enjoy broad support, as evidenced by the letter in response to the Department's RFI signed by 12 groups representing both employer sponsors of defined contribution retirement plans and the financial institutions that provide services or investments to plans.[4]

Our comments on specific elements of the proposal are set forth below.

A. THE DEPARTMENT SHOULD ENHANCE THE ABILITY OF PLANS TO USE ELECTRONIC DELIVERY AND WEB-BASED DISCLOSURE

Although the proposal contemplates the use of a Web site for layered disclosure, it otherwise simply incorporates the Department's current electronic disclosure rules. Benefits of the layered approach to disclosure in the proposal can best be realized if the Department updates its electronic disclosure rules.

Use of the Internet is now virtually universal among a significant majority of 401(k) participants. Participants under age 60 constituted 91 percent of active

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into the stated rate of return because the insurance company or bank covers its expenses and profit margin by any returns it generates on the participant's investment in excess of the stated rate of return.

[3] *See* "Collective Funds Gain Traction in 401(k)s," *Wall Street Journal*, July 24, 2008, page D1.

[4] See Joint Letter of the Investment Company Institute, American Benefits Council, American Council of Life Insurers, Committee on Investment of Employee Benefit Assets, The ERISA Industry Committee, American Bankers Association, Profit Sharing/401(k) Council of America, Securities Industry and Financial Markets Association, National Association of Manufacturers, U.S. Chamber of Commerce, The Financial Services Roundtable, and Society for Human Resource Management (July 24, 2007), available at ***http://www.ici.org/statements/cmltr/2007/07_dol_401k_joint_com.html***.

401(k) participants at the end of 2006,[5] and in this age group, access to an Internet-enabled PC at home is generally above 80 percent, based on Neilsen ratings (as of May 2008).[6] The Institute's data on mutual fund shareholders, including those who own funds through employer plans, show broad Internet usage across all groups. For example, 75 percent of mutual-fund owning U.S. households with a high school education or less report having Internet access in 2006.[7] This number is even higher—85 percent—for those with a high school education or less who own mutual funds through a 401(k).[8]

The Internet is widely used for financial transactions. One Institute member with a large recordkeeping business reported to us that in 2007, about 75 percent of investment changes by participants were made on-line via the plan participant Web site, compared with about 25 percent of changes made over the phone.[9] A 2006 Institute study of Americans who own mutual funds (whether through employer plans or through the retail market) found that nearly three-quarters of shareholders who go online use the Internet to access their bank or investment accounts, and 55 percent use the Internet to obtain investment information.[10]

In a joint letter, the Institute and the American Benefits Council recently recommended that the Department consider alternatives to the affirmative consent requirement in the Department's current electronic disclosure regulation (29 CFR § 2520.104b–1(c)). We understand that the issue of electronic delivery of information and documents required by ERISA is the subject of a separate regulatory project. We see no reason, however, why the Department could not include in these final regulations rules that facilitate electronic delivery of information required by these regulations. The Department has done so on an interim basis for e-delivery of participant benefit statements in Field Assistance Bulletin 2006–03 and for qualified default investment alternatives (QDIAs). The Department should adopt a similar user-friendly approach for this regulation.

For example, many plans enroll participants via a secure Web site. Participants designate a contribution percentage, enter enrollment information, and select investments at the same time. Information on investment options is presented at the time the participant selects investments, and the participant typically has the option to print any of this information. It is clear that any participant who enrolls via this process has access to the Internet *because the participant is online to enroll*. The Department's rules should allow the plan to furnish this participant with the required disclosures online.

The Department's final regulations for QDIAs allow plans to satisfy their notice requirements using either the Department of Labor's electronic disclosure rules or the guidance issued by the Department of Treasury and Internal Revenue Service (26 CFR § 1.401(a)–21) relating to use of electronic media.[11] The process of notifying participants about a plan's QDIA typically will be intertwined with disclosure under this new rule. The Department needs to harmonize these rules with the QDIA electronic disclosure requirements.

Finally, as a technical matter, the Department should clarify that the use of a Web site to provide the additional investment disclosure described in paragraph (d)(1)(i)(B) of the proposal will not violate the Department's general electronic disclosure rules, so long as a participant can request and receive in paper the required information that is on the Web site.[12]

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[5] *See* S. Holden, J. VanDerhei, L. Alonso, and C. Copeland, *401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2006*, ICI Perspective, vol. 13, no. 1, fig. 4, and EBRI Issue Brief, no. 308, Investment Company Institute and Employee Benefit Research Institute, August 2007, available at *http://www.ici.org/pdf/per13-01.pdf*.

[6] *See* Nielsen On-Line, *Industry Vertical News on Internet Penetration* (May 2008), available at *http://www.nielsen-netratings.com/resources.jsp?section=btn__filter&nav=5.*

[7] *See* 2008 Investment Company Institute Fact Book, 48th ed., figure 6.12, available at *http://www.icifactbook.org.* Educational attainment reported is for the sole or co-decisionmaker for savings and investing decisions.

[8] Data tabulated from ICI's 2006 Annual Mutual Fund Shareholder Tracking Survey.

[9] In fact, in 2007, 84 percent of all participant contacts with the recordkeeper were made via the participant Web site.

[10] *See* 2008 Investment Company Institute Fact Book, 48th ed., figure 6.13, available at *http://www.icifactbook.org*.

[11] *See* Preamble to Final QDIA rule, 72 Fed. Reg. 60452, 60458 (October 24, 2007). *See also* Field Assistance Bulletin 2008–3, Q&A–7.

[12] The Department should not require that all the information on the Web site, which may include information beyond that required by the rule, be available in paper at no charge. A requirement on the plan to provide a paper copy should be restricted to the information required by the regulation.

B. COMMENTS ON THE PRESENTATION AND CONTENT OF REQUIRED INFORMATION

1. The Department should clarify that the Web site information includes a description of the type of assets in the portfolio, not a list of securities in the portfolio.

Under the proposal, participants must have access to a Web site address that provides supplemental information on each designated investment alternative, including "the assets comprising the investment's portfolio." We assume that the Department intended to require information about the *type* of assets in the portfolio, and not a list of every security held in the portfolio. The current 404(c) requirement is that participants receive "information relating to the type and diversification of assets comprising the investment's portfolio." [13] Requiring web-based continuous disclosure of portfolio holdings would be unnecessary and unwise.

Mutual funds are required to disclose their portfolio holdings on a quarterly basis under SEC rules. Funds provide this information as part of their required reports provided to shareholders twice a year,[14] and then during the two "off" quarters on Form N–Q, which is filed with SEC. The Department's proposal would of course allow participants to obtain shareholder reports on request (see paragraph (d)(4)(ii)).

There are good reasons why the SEC does not require mutual funds to disclose portfolio holdings continuously and contemporaneously. Besides the administrative burden and expense of doing so, this could have an adverse impact on funds and their shareholders, because it could subject funds to predatory trading practices like front-running and free riding.[15]

2. The Department should clarify that plans may provide additional benchmark comparisons.

The proposal would require that participants receive, for each investment other than fixed return products, the name and 1-, 5-, and 10-year returns of an appropriate broad-based securities market index, for comparison purposes. The description of the required benchmark parallels what mutual funds provide pursuant to SEC Form N–1A.

Form N–1A recognizes that a broad-based securities index may not always provide the best comparison to a particular fund. The instructions to Form N–1A allow mutual funds to compare their performance not only to the required broad-based securities index, but also to other, more narrowly based indices that reflect the market sectors in which the fund invests or to use an additional broad-based index or non-securities index (e.g., the Consumer Price Index), so long as the comparison is not misleading.[16] The Department should clarify that these additional comparisons are allowed.

3. The Department should clarify that investments with less than the full period of performance should disclose performance from inception date.

The Department's proposal is modeled on SEC Form N–1A, which requires disclosure of performance over a 1-, 5-, and 10-year period, but the Department's proposal does not address explicitly how funds with less than a full period of performance should present their performance. SEC rules require that funds that have been in existence for less than a full period disclose performance for the life of the fund. For example, a fund that has been in existence for 9 years would disclose its 1- and 5-year performance and the performance over the 9 years since inception of the fund.

The model disclosure chart lists one of the funds (the "B Fund") as "NA" for the 10-year performance figure, suggesting that "NA" should be used if the fund has been in existence for less than 10 years. We recommend that the Department clarify that plans should disclose the performance for the life of the investment if that is less than 1, 5, or 10 years, as applicable. This could be done by placing the performance over the life of the fund in the column for the next highest period, and including either an explanatory parenthetical or a footnote.

[13] *See* 29 CFR § 2550.404c–1(b)(2)(i)(B)(ii). In addition, one of the items that must be available upon request under the proposal is a list of assets comprising the portfolio that constitute plan assets and the value of each such asset; this requirement is redundant if the proposal is read to require that information be continuously available on a Web site.

[14] *See* SEC Form N–1A, Item 22(b)(1); Rule 30e-1 under the Investment Company Act of 1940. Many funds voluntarily disclose this information on their Web sites on a more frequent (*e.g.*, monthly) basis, with a lag time designed to avoid subjecting the fund to predatory trading practices.

[15] If the Department intends to require disclosure of actual portfolio holdings on the Web site, it should provide that mutual funds should provide this information with the frequency, currentness, and detail required by SEC rules.

[16] *See* SEC Form N–1A, Item 2(c)(2)(iii), Instruction 2(b); Item 22(b)(7), Instruction 6.

4. If the Department retains the requirement to disclose portfolio turnover, it should clarify that funds should calculate portfolio turnover in accordance with Item 8 of Form N–1A.

Web site information for each designated investment alternative under the proposal includes the portfolio turnover rate. While we would not put fund portfolio turnover on a list of the most important pieces of information that all investors should review,[17] we understand that the Department may be concerned that participants have information about the trading costs of a fund. In that context the portfolio turnover rate can be an indicative measure, particularly for equity funds.

The SEC has determined that the fund's turnover rate is the most reasonable proxy for the trading costs of a mutual fund. While it is not a perfect measure of trading costs,[18] it is a widely-used proxy for transaction costs, and it has the advantage of comparability. It can be easily calculated by funds and is more easily understood by investors than other measures.

If the Department decides to retain the requirement in the final rule, it should apply to all investment funds—mutual funds, collective trusts, separately managed accounts, and insurance company separate accounts.

The Department should clarify that funds should calculate and disclose portfolio turnover in accordance with Item 8 of Form N–1A. This will assure comparability of disclosure across products. For example, Form N–1A instructs mutual funds, in calculating portfolio turnover, to exclude amounts relating to securities whose maturities or expiration dates at the time of acquisition were 1 year or less.[19] This is appropriate because the portfolio turnover rate is a measure of the relationship between the adviser's investment strategies and how frequently the portfolio turns over within a year.

Similarly, Item 8 of Form N–1A exempts money market mutual funds from the requirement to calculate and provide portfolio turnover.[20] Since money market funds almost exclusively hold very short-term interest-bearing securities (*e.g.*, 60 days), and hold them to maturity, most of the securities money market funds hold are exempt from the calculation because they have maturities of less than 1 year. However, because of a 1991 modification to the rules for money market funds, these funds can now purchase a security with a remaining maturity of up to 13 months. To avoid requiring money market funds to calculate portfolio turnover on a small slice of their portfolios, the SEC simply exempted all money market funds from the requirement to calculate and provide their portfolio turnover rate.[21] Disclosing money market fund portfolio turnover rate could be misleading and would not provide a comparison against the other investment options in the plan. For example, a fund that maintains an average maturity of 60 days[22] would have a turnover rate of about 600 percent.

5. The Department should clarify that shareholder-type fees that are waived for 401(k) investors should not be disclosed.

The proposal would require disclosure of "shareholder-type" fees like front-end loads and redemption fees. It is very common for mutual funds, or share classes of funds, that impose a front-end sales load or account charges to waive the load or

[17] In a survey of just over 500 households conducted in March 2008, ICI found that only 38 percent thought the section on portfolio turnover in the proposed Summary Prospectus was "very important, need to keep." Indeed, the portfolio turnover section was ranked second from the bottom in the list of 13 sections that respondents were asked to prioritize, and only the name of the portfolio manager received a lower percentage saying the information is "very important." *See* Investment Company Institute, *Investor Views on the U.S. Securities and Exchange Commission's Proposed Summary Prospectus* (March 14, 2008), available at *http://www.ici.org/pdf/ppr*_08_summary_prospectus.pdf. This finding confirmed earlier ICI research on investor preferences about portfolio turnover information. *See* Investment Company Institute, *Understanding Investor Preferences for Mutual Fund Information* (2006), available at *http://www.ici.org/pdf/rpt_06_inv_prefs_full.pdf.*

[18] For example, a fund that frequently trades securities on a low cost-per-trade basis may incur lower overall transaction costs than a fund that trades infrequently but on a high cost-per-trade basis.

[19] *See* Form N–1A, Item 8(a), Instruction 4(d)(ii).

[20] *See* Form N–1A, Item 8(a), Instruction 4(c).

[21] *See* SEC No-Action Letter to Investment Company Institute (pub. avail. Aug. 6, 1991). The SEC amended Form N–1A to reflect this interpretative position 2 years later. *See* Securities and Exchange Commission, Disclosure of Mutual Fund Performance and Portfolio Managers, Final Rule, 58 Fed. Reg. 19050, 19051 n.3 (April 6, 1993).

[22] The average maturity of taxable money market mutual funds has been lower than 60 days in every year since 1984. *See* 2008 Investment Company Fact Book, 48th ed., Table 38, available at *http://www.icifactbook.org*.

account fee for 401(k) and other defined contribution investors.[23] This would typically apply to all participants in a plan. We read the Department's proposal to provide that shareholder-type fees should be disclosed only if they apply to participants, but the Department should clarify this point. The example in the model comparative chart references a $20 annual service fee that "[m]ay be waived in certain circumstances." The Department should clarify that if a fund does not impose the fee on that plan's participants, the waived fee should not be included.

In addition, the Department's proposal would require that the 1-, 5-, and 10-year performance be calculated and disclosed in the same manner as average annual total return is calculated under Item 21 of SEC Form N–1A. That instruction requires mutual funds to assume that the shareholder paid the maximum sales load. The Department should clarify that, if a fund does not impose a sales load on the plan or its participants, the chart could omit the performance numbers that would be required in the fund's prospectus and instead display the average annual total return without including the sales load (assuming the presentation is not inaccurate or misleading).

Finally, the Department should clarify that round trip or purchase block restrictions, which do not impose a fee for exiting an investment, but merely prohibit reinvestment in the same fund for a short period of time to prevent market timing, are not considered "shareholder-type fees."[24]

6. The Department should retain the requirement to disclose quarterly only plan-level administrative fees in dollar amounts and not impose dollar-based disclosure for investment-level fees.

Under the proposal, participants would be provided quarterly the amount actually charged to their account for plan administrative expenses and any fees charged for use of individual plan services (*e.g.*, loans). These administrative expenses exclude amounts otherwise included in investment-related expenses (which are disclosed to participants at enrollment and annually thereafter). The Department should retain this feature of the proposal.

The Department should not require that plans create individualized dollar-based disclosures for fees that are included in investment-related expenses. This would require systems that are expensive to design and implement and which would produce rough estimates at best.

The SEC looked at this issue in the context of disclosure of mutual fund fees. A June 2000 General Accounting Office (now Government Accountability Office) report on mutual fund fees suggested various approaches to improving fee disclosure, one of which was to require that funds calculate and disclose to each fund investor the actual dollar amount of fund operating expenses attributable to that investor.[25] The SEC examined the GAO's report and concluded that the best way to improve shareholder understanding was to require a fee example in shareholder reports showing the expenses paid on each $1,000 invested, based both on the fund's actual operating expenses and actual return for the period and, to allow comparisons among funds, based on an assumed return of 5 percent per year.[26]

In its adopting release, the SEC cited Institute research concluding that the aggregate costs to responding firms associated with calculating and disclosing individualized fund expenses on quarterly statements would be $200.4 million in initial implementation and $65 million in annual, ongoing costs.[27] This estimate covered only the costs for calculation and disclosure to retail investors. Providing this type of disclosure in 401(k) plans would be even more costly because a plan sponsor or recordkeeper must consolidate fee and account information with respect to each investment in a participant's account, information that derives from different sources. Current recordkeeping systems are not designed to receive the needed information from mutual fund companies and other financial product providers on a daily basis.

If the Department decides to modify the proposal to require that plans reduce asset-based investment charges into estimated dollar amounts, the Department

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[23] *See* B. Reid and J. Rea, *Mutual Fund Distribution Channels and Distribution Costs*, ICI Perspective, vol. 9, no. 3 (July 2003), available at *http://www.ici.org/pdf/per09-03.pdf*.

[24] The Department came to a similar conclusion with respect to QDIAs.

[25] *See* General Accounting Office, "Mutual Fund Fees: Additional Disclosures Could Encourage Price Competition" (June 2000), available at *http://www.gao.gov/new.items/gg00126.pdf*.

[26] *See* Securities and Exchange Commission, Final Rule, Shareholder Reports and Quarterly Portfolio Disclosure of Registered Management Investment Companies, 69 Fed. Reg. 11244 (March 9, 2004).

[27] The Institute survey was conducted in 2000, and included responses from 39 mutual fund complexes with total net assets of $4.8 trillion (approximately 77 percent of total industry net assets as of June 2000).

should follow the illustrative example that accompanies the fee table in a mutual fund prospectus or the example in a fund's shareholder report.[28]

7. The Department should retain flexibility of format for the information on the Web site.

The proposal does not specify the format of the Web site information, and we agree plans should have flexibility in how to present this information. For example, many retirement services providers now use fund "fact sheets" or post web-based versions of fund fact sheets. These helpful tools, which are typically limited to one or two pages, provide basic information about a plan investment's investment objectives, risk, historical performance, and fees, in a format that investors find useful. Innovative formats like these should be encouraged.

In some cases it may be cost-effective for plans to provide at the designated Web site a copy of a mutual fund's most recent prospectus, or a short-form or summary prospectus. In addition, particularly if a mutual fund's public Web site will be used to disclose the information, the fund will need to ensure that information is presented in a way that complies with all securities laws.[29] Providing plans, service providers, and investment providers flexibility to use fact sheets, prospectuses or short-form or summary prospectuses (so long as the document includes the required information)[30] will allow plans to provide disclosure that works best for participants.

Although the Department should provide flexibility as to format, we urge the Department to provide guidance as to how the requirements apply to products other than mutual funds (which already provide the required Web site information). For example, we agree that participants should understand the risks of investing in a fixed return product. We recommend that the Department state that in describing the principal risks of these products, the plan should explain, at a minimum, that the risks associated with the fixed rate of return include the risks of interest rate changes, the long-term risk of inflation, and the risks associated with the product provider's insolvency.

8. The Department should address changes in the cross-references to Form N–1A.

The proposed regulations include references, by number, to items and instructions in the SEC's Form N–1A. The Department should clarify that these also refer to successor items and instructions. The items and instructions in Form N–1A are renumbered from time to time, and in fact the SEC's current proposed changes to Form N–1A would renumber some of them.

C. THE DEPARTMENT SHOULD REVISE THE TIMING REQUIREMENTS TO ACCOMMODATE PLANS WITH IMMEDIATE ELIGIBILITY

The Department's proposal would require that a host of plan and investment information be provided on or before eligibility. A failure to do so, under the Department's proposal, would be a breach of fiduciary duty. The point of the requirement to disclose the required information upon eligibility is to ensure participants have sufficient information to make the decision whether or not to enroll in the plan and how to allocate their contributions[31] among the options that plan fiduciaries have designated to be available in the plan.

Many participant-directed defined contribution plans provide for immediate eligibility. For these plans, the Department's rule will require, essentially, that the dis-

[28] A mutual fund's prospectus provides a quantitative example showing the dollar amount of expenses an investor would pay on a hypothetical $10,000 investment that earns 5 percent annually over 1-, 3-, 5- and 10-year periods. This calculation number takes into account any sales charges imposed by the fund. The fund's semi-annual and annual reports include a table showing the expenses paid on each $1,000 invested, based both on the fund's actual operating expenses and actual return for the most recent 6-month period and, to allow comparisons among funds, based on an assumed return of 5 percent per year.

[29] Along with the requirements of Form N–1A, other rules require that information about a fund be presented in a particular way. *See, e.g.*, Rule 482 under the Securities Act of 1933 (17 CFR § 230.482).

[30] We believe a prospectus would include all of the information described in paragraph (d)(i)(B). As proposed, a summary prospectus would also include all of this information. *See* Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies, 72 Fed. Reg. 67790 (Nov. 30, 2007).

[31] Under the proposal, the initial and annual plan-level information must identify "any designated investment managers," but does not define the term "designated investment manager." The preamble explains that this means "any designated investment managers to whom participants and beneficiaries may give investment directions." The Department should clarify that this plan-level disclosure needs to identify any person designated to receive and implement investment instructions from participants and beneficiaries (whether or not this person is an investment manager within the meaning of ERISA § 3(38)).

closure be made on the first day of work. Many employers do not provide information on benefits on the first day of work, in part to avoid information overload with all the other information new employees must absorb. Plans with immediate eligibility could be vulnerable to violating the timing requirements, if even by a few days.

Plans with immediate eligibility typically have a lag time between the date a participant is eligible and the date of first investment, because the first paycheck (with the first plan contribution deducted) often does not occur on the first day of employment. We recommend that the Department amend the requirements so that fiduciaries will be deemed to have provided timely disclosure if it is provided on or within a reasonable period after the date the employee becomes eligible for the plan, but in any event on or before the date the employee makes his or her first election to contribute to the plan or first election to allocate his or her account to a designated investment alternative.

D. THE DEPARTMENT SHOULD EXTEND THE COMPLIANCE DATE

While we believe participants are by and large already receiving the information required by the proposal, at least with respect to mutual funds, it may not be in the chart format, or at the times, required by proposal. There is programming that will be required, and coordination between plans, recordkeepers, and investment providers, which our members inform us would be impossible to complete by January 1, 2009. If the Department is able to finalize and publish the rule by the end of 2008, plans likely will be able to comply within a year, provided the Department does not substantially increase the burdens and disclosures of the proposal.

It is unclear whether the Department expects plans to provide the enrollment disclosure to all existing participants on the rule's effective date. This would be very difficult, since it would require that the industry create disclosures that would go out to millions of plan participants simultaneously. The Department should clarify that plans can provide to existing participants the annual disclosure within 1 year of the regulation's effective date. Moreover, to avoid piece meal compliance, the Department should require that plans come into compliance for new participants, and for quarterly statements, no later than when the plan provides its first annual update for the first plan year beginning on or after January 1, 2009.

E. WHILE WE AGREE THAT THE PROPOSAL WILL HAVE SIGNIFICANT ECONOMIC BENEFITS, WE BELIEVE THEY WILL RESULT FROM LOWER SEARCH COSTS AND BETTER ASSET ALLOCATION

In analyzing the rule's likely costs and benefits, the Department states that plan participants will benefit because they will be able to make better investment decisions with lower search costs. We agree. The Department estimates that the benefits over a 10-year period (in today's dollars) could be $6.9 billion to $8 billion. These estimates seem plausible. However, we believe that these estimated benefits will stem in significant part from participants being better equipped to engage in knowledgeable asset allocation rather than an assumed reduction in fees.

In the Department's analysis, benefits arise from two sources. First, plan participants will spend less time searching for information about their funds. This source accounts for roughly two-thirds of the estimated benefits. The methodology on which this estimate is based appears reasonable and could, if anything, be conservative.[32]

Second, the Department assumes that plan participants will benefit from reductions in the fees that plan participants incur through their 401(k) plans. The Department bases this on its interpretation of academic literature as suggesting that 401(k) plan participants pay fees that are on average higher than necessary by 11.3

[32] For example, to estimate the benefits from plan participants spending less time searching for information about their plans, the Department assumes that the hourly value of plan participants' leisure time is $31.3 per hour. This is based on an hourly wage rate of $35 for private sector workers participating in a pension plan, which is then reduced by 10 percent to adjust for the possibility that the opportunity cost of leisure may be less than observed wage rates for individuals. This 10 percent downward adjustment is based on a study by P. Feather and W.D. Shaw, "Estimating the Cost of Leisure Time for Recreation Demand Models," *Journal of Environmental Economics and Management*, 38(1), July 1999. It is possible that the Department relies on this finding in order to be conservative, which in our view is a sensible approach. However, the estimates in the Feather and Shaw paper are highly uncertain, are based on a small sample of individuals living in four States (Indiana, Nebraska, Pennsylvania, and Washington), and costs that individuals attach to a particular kind of recreation. In short, it is quite possible that an opportunity cost of leisure at $35 per hour for private sector workers is perfectly appropriate. If so, the Department underestimates by 10 percent the benefits of reduced search costs by plan participants.

basis points per year. We believe that this assumption is based on a misreading of the literature cited, misinterpretation of the statistics presented, and may have failed to recognize empirical difficulties in some of those studies (see attached appendix).

We agree that better information, or information presented in a more understandable way for all investment products offered to participants, may result in some participants incurring lower investment fees. For example, participants now will be able to compare fees and expenses of all pooled investment products offered in the plan, while previously there was no requirement that participants receive information on annual operating expenses for products other than registered investment companies. Participants whose plans offer more than one investment option in a particular asset class may choose the lower cost option. But we know of no evidence that would allow one to conclude that 401(k) plan participants are systematically overpaying for the investments and services they receive.

Nevertheless, as noted, we believe that the Department's estimated benefits are plausible. Along with fee information, the proposal would provide participants with information on the investment type (*e.g.*, large cap, international equity), the risks of the investments, and the historical return of each designated investment option. This information will assist plan participants to make better investment decisions. Research shows that investments with equity exposure make a positive difference in generating retirement savings.[33] For those plan participants who may be too conservatively invested given their age and risk profile, the proposed disclosure could prompt them to re-allocate their portfolios. Previous analysis conducted by the Institute shows that the majority of investors who have some exposure to equities will have accumulated more retirement assets at retirement than those with no exposure to equities.[34]

For example, according to Morningstar, the average annual return over the past decade for mutual funds that specialize in large blend domestic stocks is 5.2 percent. In contrast, the average annual return over the past decade for intermediate government bond funds is 1.3 percent. Plan participants who allocate their investments more efficiently based on the new disclosure are likely to reap higher returns over the long-term. Accordingly, we agree that the benefits of the disclosure regime that the Department has proposed justify its costs.

The mutual fund industry is committed to meaningful ERISA disclosure. Over the past 30 years, the Institute has supported efforts to improve the quality of information provided to plans and participants and the way in which that information is presented. We strongly support the Department's proposal. If you have any questions, please contact the undersigned at 202–326–5826 or Michael Hadley at 202–326–5810.

Sincerely,

MARY S. PODESTA,
Senior Counsel, Pension Regulation.

ATTACHMENT.—APPENDIX

ASSESSING THE DEPARTMENT OF LABOR'S ASSUMPTION THAT 401(K) PLAN PARTICIPANTS PAY FEES THAT ARE HIGHER THAN NECESSARY

The cost/benefit analysis in the Department of Labor's rule proposal assumes that 401(k) plan participants "on average pay fees that are higher than necessary by 11.3 basis points per year." We know of no evidence that would allow one to draw such a conclusion.

It is unclear how the Department reaches this 11.3 basis point figure. The Department cites a number of academic studies and industry studies in support of this es-

[33] *See* S. Holden and J. VanDerhei (2005) "The Influence of Automatic Enrollment, Catch-Up, and IRA Contributions on 401(k) Accumulations at Retirement," *ICI Perspective*, Vol. 11, No. 2 and *EBRI Issue Brief*, No. 283, Washington, DC: Investment Company Institute and Employee Benefit Research Institute, July 2005.

[34] *See* letter from Brian Reid, Chief Economist, and Elena Barone, Assistant Counsel, Investment Company Institute, to Susan Dudley, Administrator, Office of Information and Regulatory Affairs, Office of Management and Budget, dated May 31, 2007. For example, a worker who begins investing at age 30 could expect, on average, to have more than twice the retirement assets at retirement by investing in a lifecycle fund with exposure to equities than in a stable value fund. Lifecycle funds performed better than stable value funds in the vast majority of cases, even for investors who began to make contributions later in life, when the lifecycle fund would be more conservatively invested with less exposure to equities.

timate.[35] No such estimate appears in any of these studies and the Department provides no details on how it arrived at the 11.3 basis point estimate. Presumably, the Department calculated the 11.3 basis points from statistics presented in the studies it cites. If so, this calculation likely misinterpreted the statistics in those studies, misapplied some of those studies to 401(k) plans, and failed to recognize empirical difficulties inherent in some of those studies. In addition, the Department's cost/benefit study failed to consider evidence showing that the mutual fund industry[36] is highly competitive.

While we agree that the rule the Department has proposed may result in some participants paying less in investment-related fees (although some may pay more if their asset allocation results in more equity exposure), there is no basis for concluding that plan participants systematically overpay for the investments and services they receive.

Misinterpretation of Statistics Presented in the Literature Cited by the Department: The Department's cost/benefit analysis argues that dispersion in 401(k) fees implies market inefficiency.[37] As evidence, the Department points to a study by the Institute of average costs incurred by participants in 401(k) plans (not "the fees that plans pay" as the Department suggests).[38] Figure 9 in the cited Institute study shows that the bulk (77 percent) of the 401(k) plan assets invested in stock mutual funds are invested in funds with expense ratios of less than 1 percent.[39] The remainder (23 percent) is invested in stock funds with expense ratios of 1 percent or more.

These percentages, however, say little, if anything, about market efficiency or whether plan participants overpay or underpay for the services they receive. The percentages are driven largely by the broad asset allocation decisions that plan participants make, not by whether plan participants pay too much or too little for a given type of fund. For example, nearly half of the 23 percent of 401(k) plan assets that are invested in stock funds with expense ratios of 1 percent or more are invested in international equity funds. International equity funds tend to be more costly to manage and therefore have higher expense ratios than domestic equity funds (especially large-cap domestic equity funds).[40] Plan participants who choose to invest in a mix of domestic equity and international funds will incur higher fees than participants who invest only in domestic equity funds, but they also expect to earn higher returns.

Dispersion in 401(k) fees can also reflect differences in plan services or characteristics, differences in employer subsidization of plans, and differences in arrangements for how plan participants and employers defray plan administrative costs. For example, as the ICI study discusses, the costs of running a 401(k) plan gen-

[35] The Department's cost/benefit analysis cites six papers in support of its view that plan participants pay fees that are on average too high by 11.3 basis points: Brad M. Barber, Terrance Odean and Lu Zheng, "Out of Sight, Out of Mind, The Effects of Expenses on Mutual Fund Flows," *Journal of Business*, 79(6), 2095–2119, 2005; James J. Choi, David I. Laibson, and Bridgette Madrian, "Why Does the Law of One Price Fail? An Experiment on Index Mutual Funds," NBER working paper W12261, May 2006; Deloitte Financial Advisory Services LLP, *Fees and Revenue Sharing in Defined Contribution Plans*, December 6, 2007; Edwin J. Elton, Martin J. Gruber, and Jeffrey A. Busse, "Are Investors Rational? Choices Among Index Funds," NYU working paper, June 2002; Sarah Holden and Michael Hadley, "The Economics of Providing 401(k) Plans: Services, Fees, and Expenses 2006, *Fundamentals*, 16(4), September 2007; and Jason Karceski, Miles Livingston, and Edward O'Neal, "Portfolio Transactions Costs at U.S. Equity Mutual Funds," University of Florida working paper, 2004.

[36] The Department's analysis and cited references appear to relate almost exclusively to mutual fund fees, and as a result (and because of the Institute's expertise), our comments also relate to mutual fund issues. The Department's analysis is incomplete because mutual funds represent only about half of the assets in participant-directed plans. We believe one benefit of the proposal is that participants will now be able to compare fees and expenses of all pooled investments.

[37] There is a "wide dispersion of fees paid in 401(k) plans. As supported by a report of the Investment Company Institute, the fees that plans pay vary over a wide range. According to their study, 23 percent of 401(k) stock mutual fund assets are in funds with expense ratios of less than 50 basis points, while an equal amount are in funds with an expense ratio of over 100 basis points. Some of this variation could be explained by varying amounts of assets in plans and their accompanying economies of scale. In addition, some plans might offer more, or more expensive, plan features. The Department believes, however, that a significant portion of the variation in plan fees is due to market inefficiencies." 73 Fed. Reg. at 43020.

[38] *See* Sarah Holden and Michael Hadley, "The Economics of Providing 401(k) Plans: Services, Fees, and Expenses, 2006," *Fundamentals*, Vol. 16, No. 4, September 2007 (hereinafter Holden and Hadley), available at *http://www.ici.org/pdf/fm-v15n7.pdf*.

[39] *See* Holden and Hadley, Figure 9, page 13.

[40] As evidence, *see* Figure 8 in Holden and Hadley, which shows that in 2006 the average expense ratio incurred by 401(k) plan participants for investing in foreign stock funds was 97 basis points, compared to 70 basis points incurred for investing in domestic stock funds.

erally are shared by plan sponsors and participants and these arrangements can vary widely. Many employers voluntarily cover some or all of plan-related costs that plan participants would otherwise incur. Thus, an employer's decision to pay a portion of plan costs can have a significant effect on the 401(k) plan fees charged to plan participants. Generally, when more plan costs are subsidized by employers, plan participants incur lower fees.[41]

Literature Cited Inapplicable to 401(k) Plans: The Department states that a "review of the relevant literature suggests that plan participants, on average, pay fees that are higher than necessary by 11.3 basis points per year." In support, the Department references six studies. Only two of these studies, those by the ICI and Deloitte Financial Advisory Services LLP, relate to 401(k) plans. The ICI and Deloitte studies provide evidence on the level of fees that plan participants pay, not whether they overpay or underpay for services received. To judge from these studies whether plan participants pay too much or too little, one would have to determine the "right" level of fees and services. Neither study does this, nor is it obvious how one would go about determining such a level.

The remaining four studies consider neither 401(k) fees nor the behavior of 401(k) plan investors. Two of the studies consider choices made by *load fund* investors.[42] A third study compares the fees charged by load and no-load S&P 500 index funds.[43] Since 401(k) plan investors do not generally incur load fees, these three studies would appear to be irrelevant. The fourth study examines brokerage fees incurred by equity mutual funds.

Empirical Difficulties with the Studies Cited by the Department: Putting aside the relevance of the studies cited by the Department, some of these studies have empirical issues that challenge the validity of their conclusions generally.

For example, the Department cites a study by Elton, Gruber, and Busse (2002) on the expenses of S&P 500 funds.[44] That study claims, on the basis of the expense ratios of S&P 500 funds available in the marketplace, that investors make irrational choices when selecting mutual funds. The ICI has previously disputed that claim,[45] showing that: (a) S&P 500 index funds are commodities in that they have essentially identical portfolios; (b) these funds nevertheless differ from one another in many respects; and (c) nearly all of the dispersion in the expense ratios of S&P 500 funds is explained by fund characteristics (such as fund size and investors' average account balances) rather than by market inefficiency or investor irrationality.

In addition, Elton, Gruber, and Busse (2002) claim that a "large amount of new cash flow goes to the poorest-performing [S&P 500 index] funds."[46] That is incorrect: over the 10-year period 1998 to 2007, about 85 percent of the net new cash flowing to S&P 500 index funds went to the least costly funds, those with expense ratios of 20 basis points or less.[47] Elton, Gruber, and Busse (2002) appear to reach this inappropriate conclusion because they analyze flows *scaled by assets* rather than dollar flows. As a result, in their study, very small funds can have a disproportionate influence.

In addition, the paper by Barber, Odean, and Zheng (2005) is subject to alternative interpretations. Barber, Odean, and Zheng (2005) claim to have found that "[i]investors are more sensitive to salient in-your-face fees, like front-end loads and commissions, than [fund] operating expenses." One statistic that Barber, Odean, and Zheng (2005) provide in support is that repeat buyers of front-end load funds tend to pay lower loads on subsequent purchases than on initial purchases, while repeat purchasers of all funds tend to pay nearly identical expense ratios on initial and subsequent purchase. Our view is that this says little, if anything, about whether investors are sensitive to front-end loads and fund expense ratios. Instead, it simply illustrates how front-end load funds are priced: front-end load funds typically offer

[41] *See*, for example, Figure 4 in Holden and Hadley, which shows that about 40 percent of plan sponsors pay some or all 401(k) recordkeeping and administrative costs.

[42] Brad M. Barber, Terrance Odean and Lu Zheng, "Out of Sight, Out of Mind, The Effects of Expenses on Mutual Fund Flows," *Journal of Business*, 79(6), 2095–2119, 2005; James J. Choi, David I. Laibson, and Bridgette Madrian, "Why Does the Law of One Price Fail? An Experiment on Index Mutual Funds," NBER working paper W12261, May 2006.

[43] Edwin J. Elton, Martin J. Gruber, and Jeffrey A. Busse, "Are Investors Rational? Choices Among Index Funds," NYU working paper, June 2002.

[44] *Id*.

[45] *See* Sean Collins, Investment Company Institute, "Are S&P 500 Index Mutual Funds Commodities," *Perspective*, Vol. 11, No. 3, August 2005.

[46] Edwin J. Elton, Martin J. Gruber, and Jeffrey A. Busse, "Are Investors Rational? Choices Among Index Funds," NYU working paper, June 2002, page 25.

[47] Investment Company Institute, *2008 Investment Company Factbook*, 48th edition, page 65.

discounts on load fees when the cumulative dollar value of shares purchased exceeds a given dollar amount.[48]

Another issue is that some of the studies cited by the Department rely on samples that are representative of neither 401(k) plan participants, nor mutual fund investors in general. One of the studies—Barber, Odean, and Zheng (2005)—relies on a sample of load fund investors provided by a *single* brokerage firm. Another study cited by the Department—the study by Choi, Laibson, and Madrian (2006)[49]—relies on a survey that asks a relatively small number of individuals how they *would* invest in load funds, not how they do invest. It is unclear whether the surveyed individuals are 401(k) plan participants, whether they have any mutual fund investments, or any investments at all.

The Mutual Fund Market is Highly Competitive: Finally, the Department failed to cite studies indicating that the mutual fund industry is highly competitive. The textbook definition of a competitive industry is one in which there are many firms, none of which has a dominant market share. Firms may freely enter or exit the industry, and consumers are free to vote with their feet. In a competitive industry, firms cannot overcharge and consumers do not "overpay."

The mutual fund industry is "a classic, competitively structured industry, with hundreds of competing firms offering thousands of products, low barriers to entry . . . and low concentration."[50] About 600 advisers manage mutual fund assets in the United States. Competition has prevented any one firm from dominating the market. For example, of the largest 25 fund complexes in 1985, only 13 remained in this top group in 2007.[51] Other measures also indicate that the fund market is competitive. In 2007, for instance, the industry had a Herfindahl index (a standard measure of industry concentration) of 440; index numbers below 1,000 indicate that an industry is unconcentrated. In addition, competition in the fund industry is fostered by low barriers to entry. Indeed, the number of mutual fund advisers nearly tripled from 1984 to 2004.[52]

Fund investors are mobile: they can take their investments elsewhere if they feel a given fund's fees are too high. To be sure, in a typical 401(k) plan, participants are limited to the menu of investments selected by plan fiduciaries. But plan fiduciaries can and do alter plan menus in order to replace poorly performing funds[53] and plan participants can select from among funds in a plan's menu. There is considerable evidence that 401(k) plan participants invest in low cost funds. For example, although the fees of S&P 500 index funds exhibit considerable dispersion, nearly all (more than 90 percent) of 401(k) plan assets invested in S&P 500 funds are in the least costly of such funds (those with expense ratios of 20 basis points or less).

As we state in our letter, we agree that the Department's proposed disclosure regime will have significant benefits. But there is no basis for concluding that plan participants systematically overpay for the investments and services they receive in their 401(k) plans.

[48] Thus, for example, an investor who initially invests $25,000 and pays a front-load of 5.25 percent might expect to pay a front-load of just 3.00 percent on a subsequent purchase of $25,000 in the same front-end load fund.

[49] James J. Choi, David I. Laibson, and Bridgette Madrian, "Why Does the Law of One Price Fail? An Experiment on Index Mutual Funds," NBER working paper W12261, May 2006.

[50] John C. Coates IV and R. Glenn Hubbard, "Competition and Shareholder Fees in the Mutual Fund Industry: Evidence and Implications for Policy," American Enterprise Institute, working paper #127, June 2006, page i.

[51] *See* Investment Company Institute, *2008 Investment Company Factbook*, 48th edition, page 21.

[52] *See* Table 1 in John C. Coates IV and R. Glenn Hubbard, "Competition and Shareholder Fees in the Mutual Fund Industry: Evidence and Implications for Policy," American Enterprise Institute, working paper #127, June 2006.

[53] See Deloitte Consulting, 401(k) Benchmarking Survey, 2008 Edition, page 22. The report finds that 95 percent of responding plan sponsors evaluate and benchmark their plan's investments at least annually, and that 64 percent have replaced a fund due to poor performance in the past 2 years.

AARP,
WASHINGTON, DC 20049,
September 16, 2008.

Hon. EDWARD M. KENNEDY,
Committee on Health, Education, Labor, and Pensions,
U.S. Senate,
Washington, DC 20510.

Hon. MICHAEL B. ENZI,
Committee on Health, Education, Labor, and Pensions,
U.S. Senate,
Washington, DC 20510.

DEAR MR. CHAIRMAN: AARP commends you and the other members of the committee for holding this timely hearing on the need for comprehensive, informative and timely disclosure of fee and expense information to defined contribution plan participants. Thank you for providing us with this opportunity to submit this statement and the attached reports for the record of this hearing. AARP also appreciates the opportunity to comment on S. 2473, the Defined Contribution Fee Disclosure Act of 2007 introduced by Senator Tom Harkin. AARP supports the enactment of S. 2473 and urges the members of the committee to approve this measure as soon as possible.

With 40 million members, AARP is the largest organization representing the interests of Americans age 50 and older and their families. About half of AARP members are working either full-time or part-time. All workers need access to a retirement plan that supplements Social Security's solid foundation. For those who participate in a defined contribution plan, such as a 401(k) plan, better and easy to understand information is essential to help them make prudent investment decisions.

There were approximately 50 million active participants in 401(k) plans in 2006, and overall, 401(k) plans held more than $2.7 trillion in assets. These plans have become the dominant employer-based pension vehicle. The participants in these plans have a need and a right to receive timely, accurate, and informative disclosures from their 401(k) plans to help them prepare for a financially secure retirement. The fee information participants currently receive about their plan and investment options is often scattered among several sources, difficult to access, or nonexistent. Even if fee information is accessible, plan investment and fee information is not always presented in a way that is meaningful to participants. This must change because fees reduce the level of assets available for retirement.

The Government Accountability Office (GAO) estimated that $20,000 left in a 401(k) account that had a 1 percentage point higher fee for 20 years would result in an over 17 percent reduction—over $10,000—in the account balance. We estimate that over a 30-year period, the account would be about 25 percent less. Even a difference of only half a percentage point—50 basis points—would reduce the value of the account by 13 percent over 30 years. In short, fees and expenses can have a huge impact on retirement income security levels.

AARP commissioned a report in 2007 to determine the extent to which 401(k) participants were aware of fees associated with their accounts and whether they knew how much they actually were paying in fees. The report revealed participants' lack of knowledge about fees as well as their desire for a better understanding of fees. In response to these findings, the report suggested that information about plan fees be distributed regularly and in plain English, including a chart or graph that depicts the effect that the total annual fees and expenses can have on a participant's account balance. I have attached a copy of this report, 401(k) Participants' Awareness and Understanding of Fees,[54] July 2007, for the consideration of the members of the committee.

AARP commissioned a second study in 2008 to gather information and evaluate a model fee disclosure form developed by the Department of Labor and an alternative disclosure form developed by AARP. I have attached a copy of this report entitled, "Comparison of 401(k) Participants Understanding of Model Fee Disclosure Forms Developed by the Department of Labor and AARP."[55] The report suggests that a disclosure form that contains participant-specific information and actual dollar figures may improve participants' comprehension of the form. The report also suggests modifications in the DOL form that would make it more helpful to 401(k)

[54] The report referred to may be located at *http://assets.aarp.org/rgcenter/econ/401k_fees.pdf.*

[55] The report referred to may be located at *http://assets.aarp.org/rgcenter/econ/fee_disclosure.pdf.*

plan participants. A copy of this report was provided to the Department of Labor as part of our comments on the Department's proposed rule on fee disclosure for participant-directed individual account plans.

AARP's Public Policy Institute has just published the attached paper entitled, "Determining Whether 401(k) Plan Fees are Reasonable: Are Disclosure Requirements Adequate?"[56] The paper explains how excessive fees on 401(k) plans can drastically reduce the size of a retirement nest egg and documents the unsatisfactory state of fee disclosure and the lack of knowledge about fees among plan participants. The paper argues convincingly for a reform of the current regulatory framework to provide participants with the clear and basic information necessary for them to make better-informed investment decisions.

AARP supports the enactment of S. 2473. The bill would establish a solid framework for providing timely information about fees and expenses to plan participants in a format that is easy for them to understand. The bill would require plan sponsors to provide a complete picture of investment options to participants—including risk, fees, and historic returns, as well as certain basic information to help investors better understand their investment options and whether those investments will provide long term retirement security on their own or if greater diversification is needed. The comprehensive annual benefit statement required by S. 2473 would provide a more complete picture of a participant's 401(k) status than available under current law. All of the information that a participant needs would be available in a single disclosure form, rather than requiring a participant to piece together information from several different documents.

AARP commends you and the committee for your commitment to preserve and enhance retirement security. We look forward to working with you and the other members of your committee to enact legislation as soon as possible that would require defined contribution plans to disclose comprehensive, informative and timely information about fees and expenses to plan participants.

If you have any questions or need additional information, please feel free to call Cristina Martin Firvida, Director of Economic Security in Government Relations at 202–434–6194.

Sincerely,

DAVID P. SLOANE,
Senior Vice President,
Government Relations and Advocacy.

[Whereupon, at 11:23 a.m., the hearing was adjourned.]

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[56] The report referred to may be located at *http://assets.aarp.org/rgcenter/econ/i8_fees.pdf*.